



CANADIAN ASSOCIATION
OF INCOME FUNDS

L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

250 CONSUMERS ROAD, SUITE 301
250 RUE CONSUMERS, SUITE 301
TORONTO, ON M2J 4V6
TEL / TÉL: 416-497-5864 • FAX / TÉLÉC: 416-495-8723
EMAIL / COURRIEL: INFO@CAIF.CA

February 5, 2008

Competition Policy Review Panel
280 Albert Street, 10th Floor
Ottawa, ON
K1A 0H5

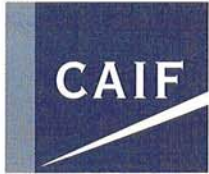
We are pleased to forward to your Committee the following key points on behalf of the membership of the Canadian Association of Income Funds (CAIF) – an association which comprises a constituency of over \$100 billion in market capitalization, and whose members employ over 250,000 Canadians spanning trusts from all business sectors of the economy and across the country. We believe the Canadian income trust sector plays – and will continue to play – a vital role in our economy. We note that the income trust vehicle remains an important financial instrument and that the Minister of Finance has stated publicly the Government's intent is not to eliminate it.

We note at the outset two essential questions your Committee has set out as critical to Canada's economic performance: first, how best to create the domestic conditions to foster the development of Canadian-based global businesses; and second, how to best position Canada to be a world-leading destination for talent, capital and innovation.

We wish to bring to the committee's attention the competitive challenges currently facing the Canadian income trust sector. This diminished competitiveness is due to the unintended negative consequences of the government's October 31, 2006 income trust policy and the uncertainty associated with its implementation.

Although the Government's stated intent was to level the playing field between trusts and corporations this has not been its effect to date. On the contrary, the effect has been twofold: first, a permanent impairment of market valuations (see attached market data: S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index - January 1, 2005 to January 31, 2008). And second, the placing of an immediate 'chill' on capital markets' treatment of the sector. This has left the trust sector unable to access capital at a competitive cost and made it highly susceptible to takeover by entities with significant cost of capital advantage (see attached market data titled: Weighted Average Cost of Capital).

As a result, we are witnessing the 'hollowing out' of this sector. Since late 2006, there have been more than 42 transactions take place that involve the selling, merging, or acquisitions of income trusts with an enterprise value in excess of 32 billion dollars. The majority of these transactions by dollar value have involved 'tax exempt' entities. Most takeovers have gone into the hands of private equity players, especially in the U.S., domestic pension funds and more recently, sovereign wealth funds. This includes foreign buyers of Canadian assets which is causing important Canadian business assets to move into non-resident hands, and in many instances the 'mind and management' of these entities moving out of Canada as well. In this regard, we refer your Committee to the recent Deloitte study (reference attached) which outlines the takeovers to date and the nature of the entities involved in these takeovers.



CANADIAN ASSOCIATION
OF INCOME FUNDS

L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

Although the benefits of foreign investment as an economic driver are well known, the case of the resource sector is quite different, particularly where there is no reciprocity of access to the capital market of the purchaser, as in the case of sovereign wealth funds. In such cases, the benefits are not at all clear and merit study.

Also as a result of these entities exiting the publicly traded markets, individual Canadian investors are increasingly unable to participate in this form of ownership of, for example, the Canadian resource sector, a unique form that was available to the majority of ordinary Canadians. Moreover, investments in traditional resource companies are both expensive and yield dividend payments that do not provide the level of cash flow investors need to supplement retirement incomes. In fact, recent estimates indicate that only 13% of those entities which have been taken over remain publicly traded thus preventing Canadian investors from participating any longer in the very competitive returns still being generated by these former trust assets.

By way of further example, junior resource trusts are caught in the double bind of not being able to grow as a result of the limits on growth imposed in the Government's policy (and the implementing legislation, Bill C-52). Yet they also suffer from not being able to access capital at competitive costs. These trusts are therefore even more vulnerable to takeover by entities, often non-resident, with significant cost of capital advantages. In the meantime, their ability to invest and create jobs, particularly in the non-urban centers, is severely impaired.

In our view, this 'hollowing out' must be addressed by the Federal Government as soon as possible. It is only being exacerbated by the continuing uncertainty over key aspects of the Government's policy on trusts. We therefore urge your Committee to recommend that the Federal Government resolve key issues related to its transition period, taking into consideration the deleterious impact on federal revenues of the accelerating hollowing out of a key sector of Canadian capital markets.

We request an opportunity to meet with your Committee at its earliest convenience in order to elaborate on these points.

Sincerely,

Margaret Lefebvre
Executive Director
Canadian Association of Income Funds/
L'Association canadienne des Fonds de Revenu
514-935-4131
mml@caif.ca
www.caif.ca

Income trust buyouts: Lots of activity, little tax revenue

Since the fateful announcement on October 31, 2006, there have been 40 announced or completed trust buyouts versus 14 deals over the equivalent year-ago period. We have seen the trust population of 256 shrink by more than 15% to 215. Market conditions such as foreign exchange fluctuations and commodity prices also had an impact on this decline, but the trust tax announcement was certainly the catalyst for the sell-off.

In December 2006, Deloitte hosted an event titled [New realities for income trusts](#) for trustees and management of income trusts, and their investors, bankers and advisors. The participants were asked to estimate the number of trusts that would still exist at the end of 2010 – and 87% responded “fewer than 100.” A decline of this magnitude translates to almost 40 trusts per year – closely in line with current reality.

Of the 40 deals that originated since October 31, 2006, 31 have closed and 9 are pending completion. Many other trusts have been targeted during this period, with at least one publicly disclosing a takeover attempt that was subsequently terminated.

	Strategic buyer		Private equity		Nov-06 to Oct-07	Nov-05 to Oct-06
	Domestic	Foreign	Domestic	Foreign		
Business trusts	5	6	6	8	25	6
Energy trusts	3	-	1	2	6	5
REITs	2	2	1	-	5	3
Power & pipelines	2	-	-	2	4	-
Total	12	8	12	12	40	14

Source: Capital IQ, FPinformart

What sectors were targets?

Following the trust tax announcement, the increase in buyout activity was concentrated in the business trust sector, spread across 10 subsectors. The generally smaller size (average transaction enterprise value of \$430 million) of business trusts may have motivated trustees to sell – but performance may have been a contributing factor. Twelve of the business trusts acquired were bought for less than or equal to their \$10 initial public offering (IPO) price.

	Strategic buyer		Private equity		Nov-06 to Oct-07	Nov-05 to Oct-06
	Domestic	Foreign	Domestic	Foreign		
Capital goods	-	1	-	3	4	3
Commercial service suppliers	1	1	1	1	4	-
Consumer staples	-	2	1	1	4	-
Diversified financials	-	-	1	-	1	-
Leisure	-	1	-	-	1	-
Materials	-	1	-	-	1	-
Media	2	-	1	-	3	1
Retail	1	-	1	1	3	-
Telecommunications	1	-	-	-	1	1
Transportation	-	-	1	2	3	1
Total business trusts	5	6	6	8	25	6

Source: Capital IQ, FPinformat

Energy trust activity remained consistent year over year, although there were two foreign buyouts as opposed to exclusively trust mergers prior to the announcement.

The REIT and Power & pipelines sectors experienced an increase in interest by foreign buyers and Canadian pension funds. The characteristics of both of these sectors lend well to the infrastructure-based investing that many pension funds and foreign buyers are looking for, and should result in continued buyout activity.

Buyers are largely tax-exempt

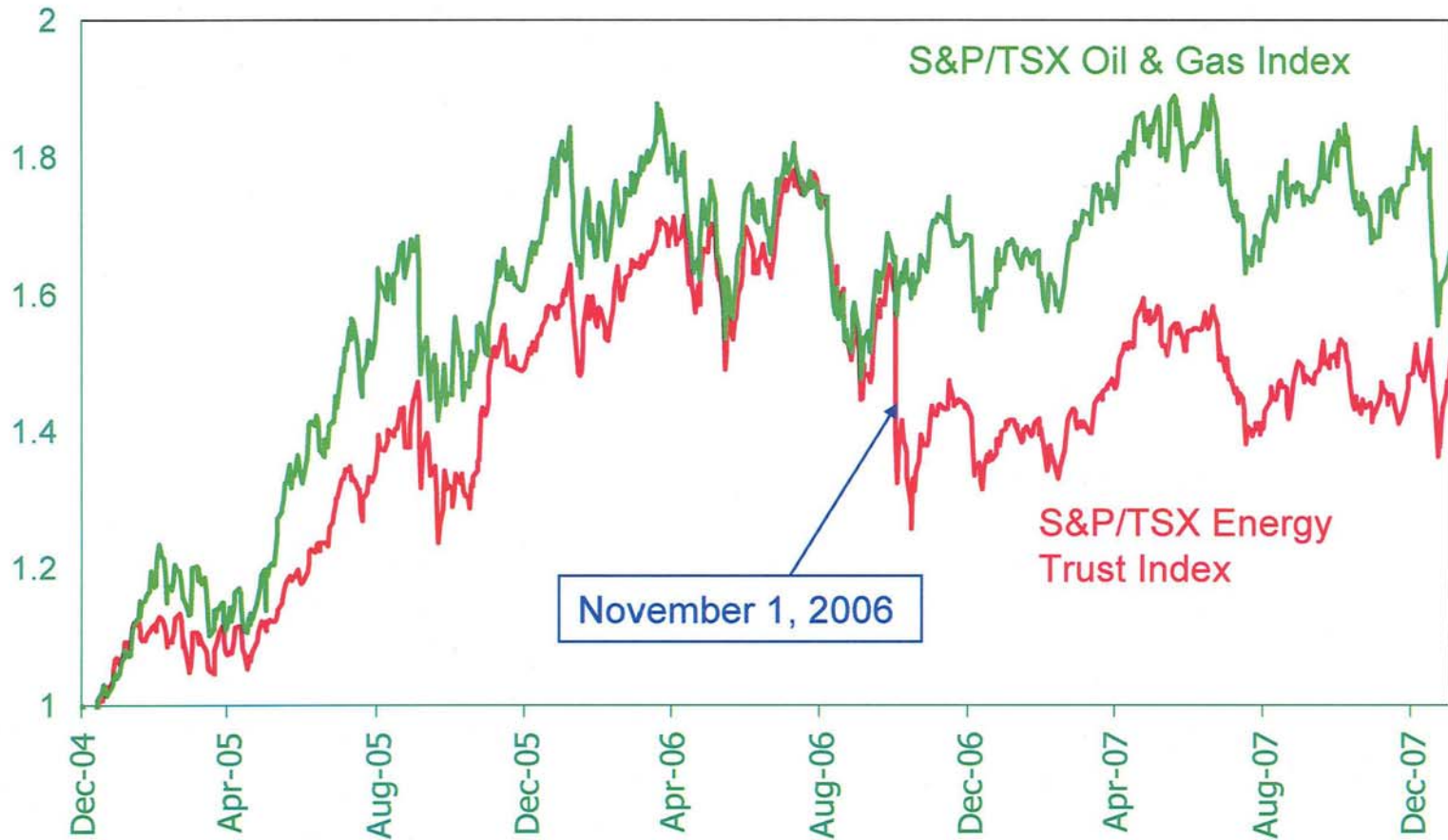
Buyers in the 40 announced deals were equally split between strategic and private equity, as well as between domestic and foreign. But in terms of tax revenue for the Canadian government, the news was not so balanced: 70% of the purchasers are tax exempt pension/private equity funds or foreign buyers who pay little if any tax in this country.

What structures were buyers using to acquire trusts? In 22 of the 40 transactions, trust units were acquired; in the other 18, the purchaser acquired shares of subsidiary corporations, trusts or partnerships. The method of acquisition has significant implications for the buyer, trustees and unitholders. The entity left "holding the bag" has to bear the cost and risk associated with the wind-up of the engineered trust. A caveat for future purchasers: all parties should consider the implications of a proposed structure when assessing the value and risk of an offer for a trust.

Based on our involvement with over 20 income trust buyout transactions in the past year we believe that the buyout momentum will continue. The current M&A slowdown is primarily driven by "mega" transactions exceeding \$1 billion in size. The income trust market, particularly the business trust segment, is comprised of medium-sized companies that are ideal for financial and strategic buyers. Clearly, volatility in the income trust sector is far from over.

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index January 1, 2005 to January 31, 2008

Relative
Strength



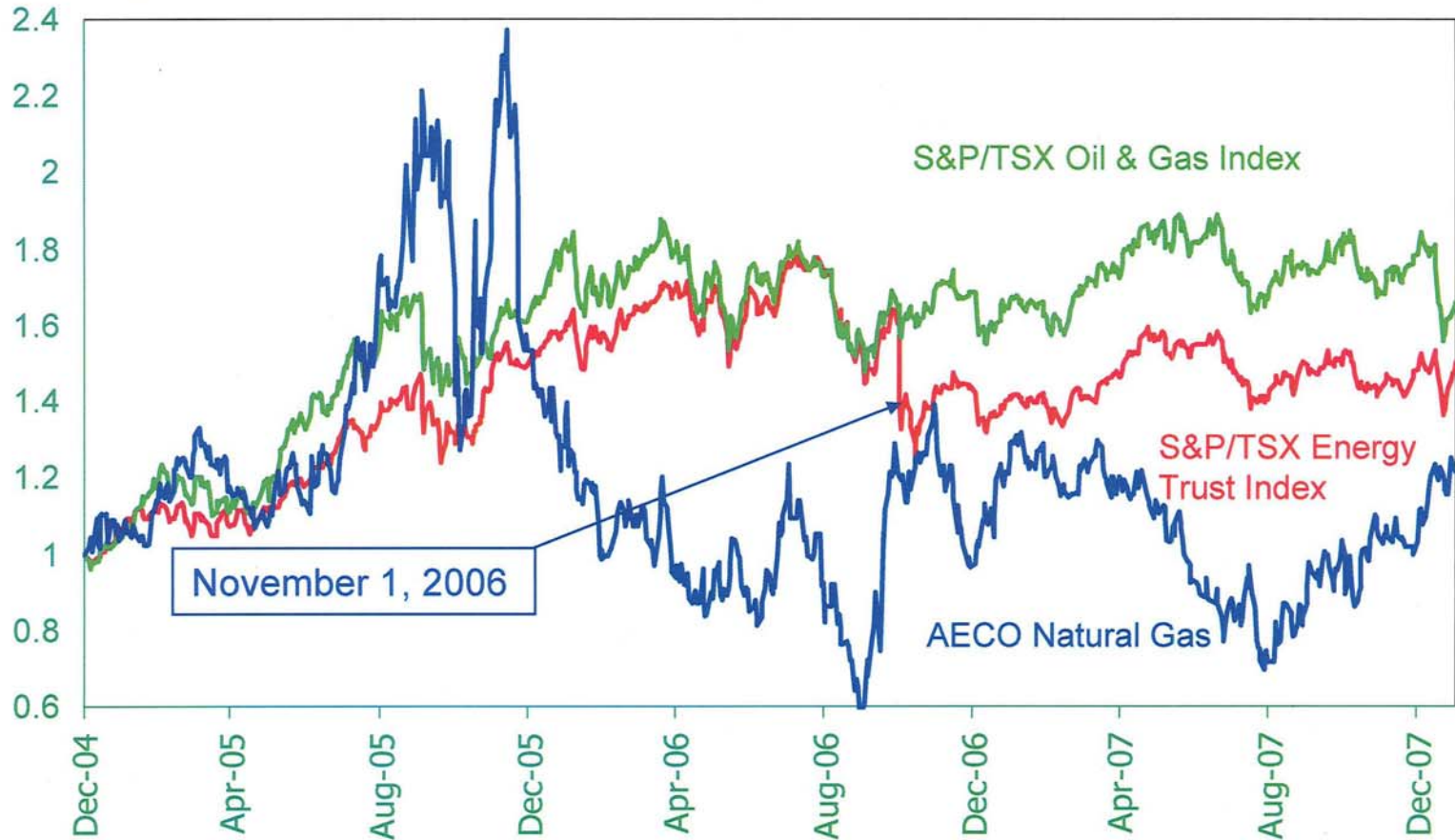
to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index vs. AECO Gas Price January 1, 2005 to January 31, 2008

Relative Strength



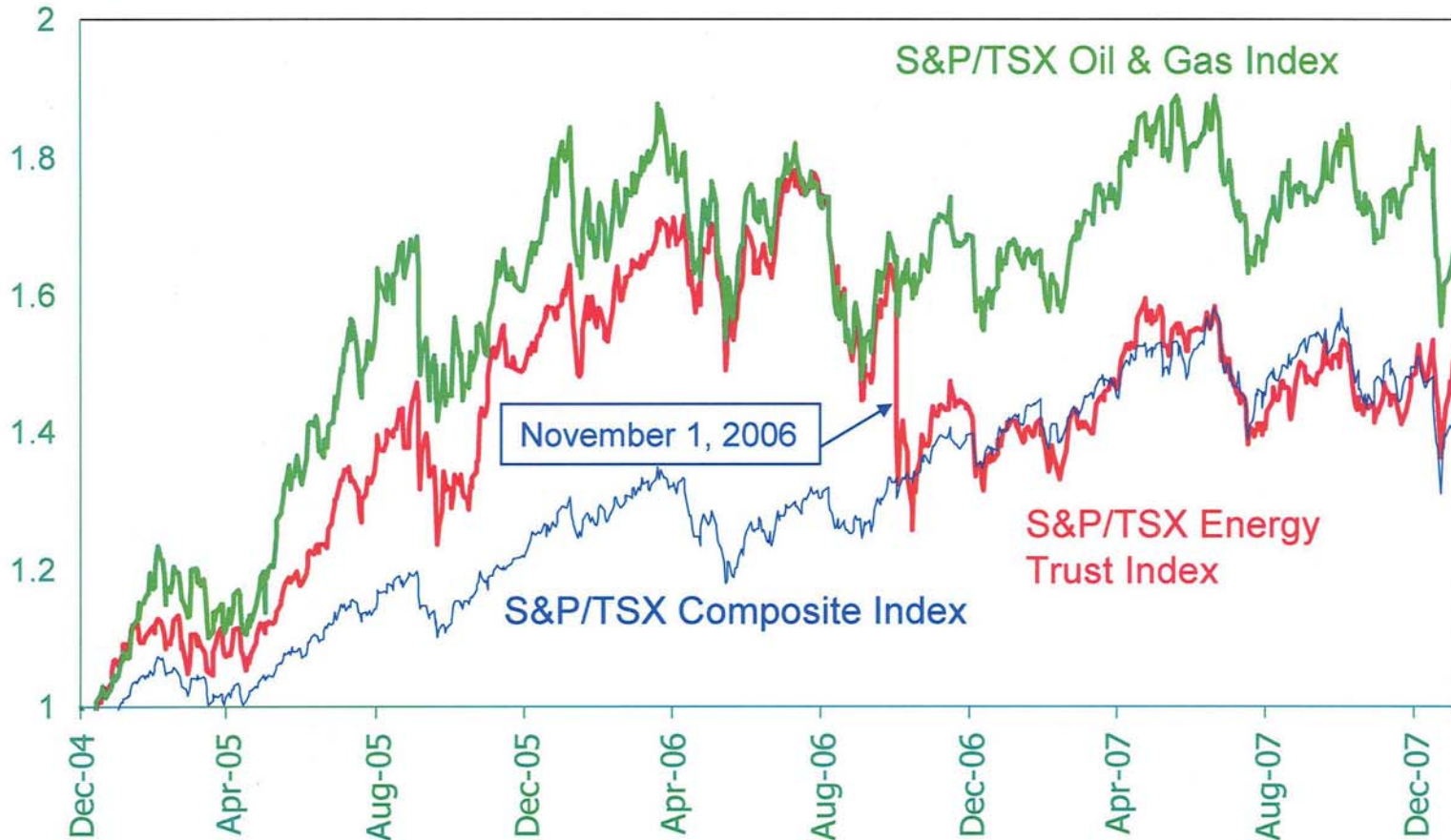
to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index January 1, 2005 to January 31, 2008

Relative
Strength



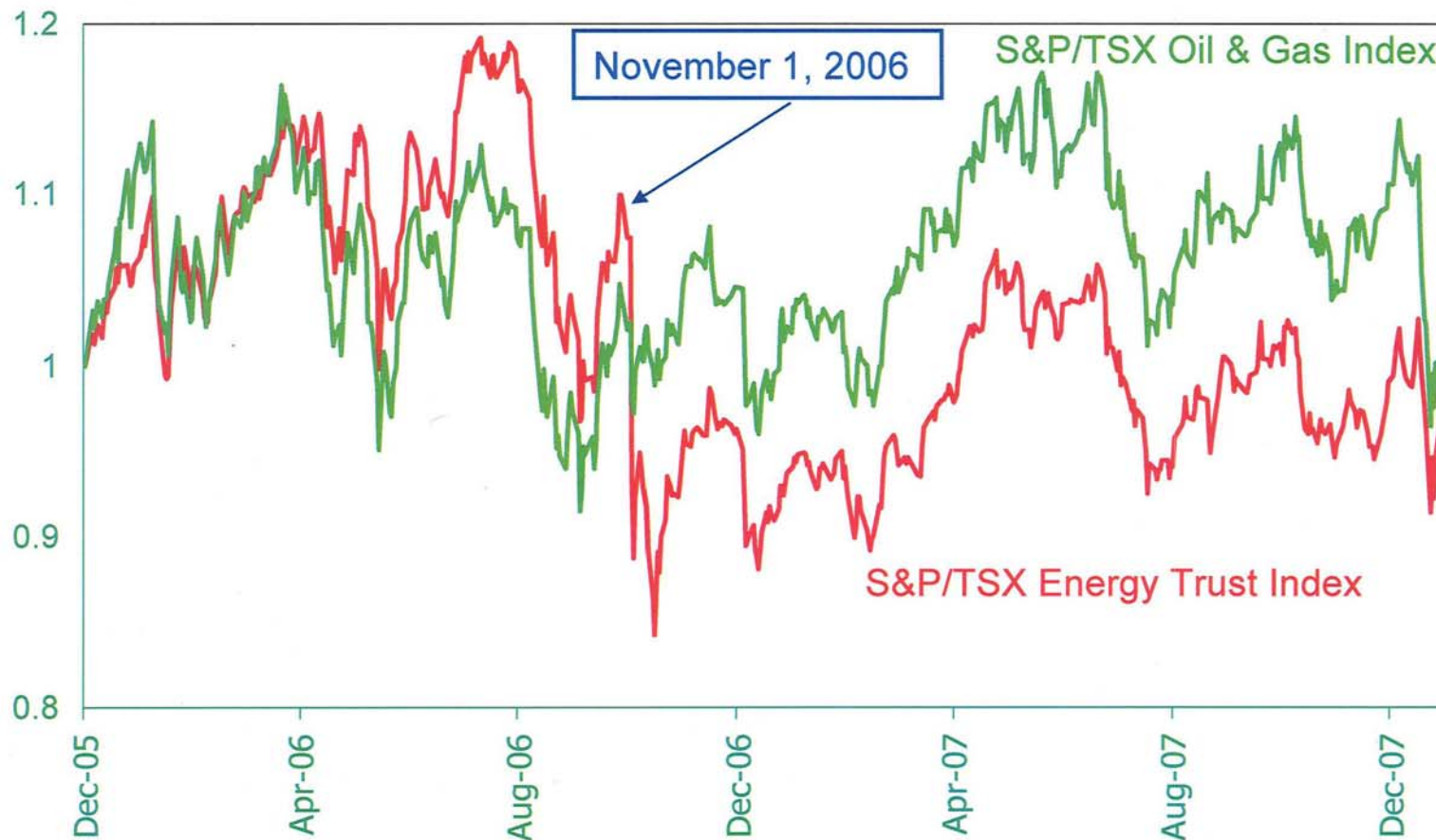
to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index January 1, 2006 to January 31, 2008

Relative
Strength



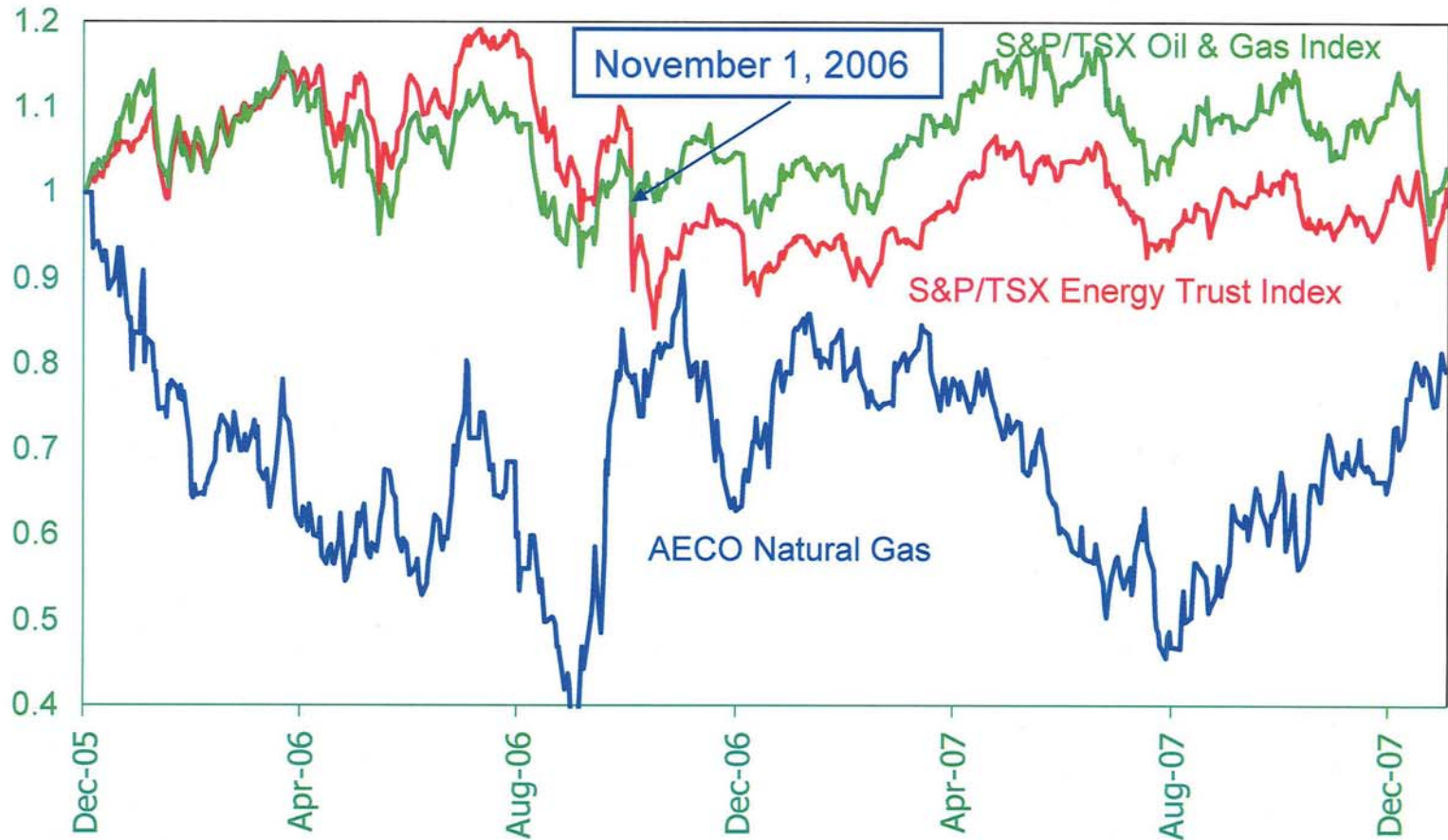
to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index vs. AECO Gas Price January 1, 2006 to January 31, 2008

Relative Strength



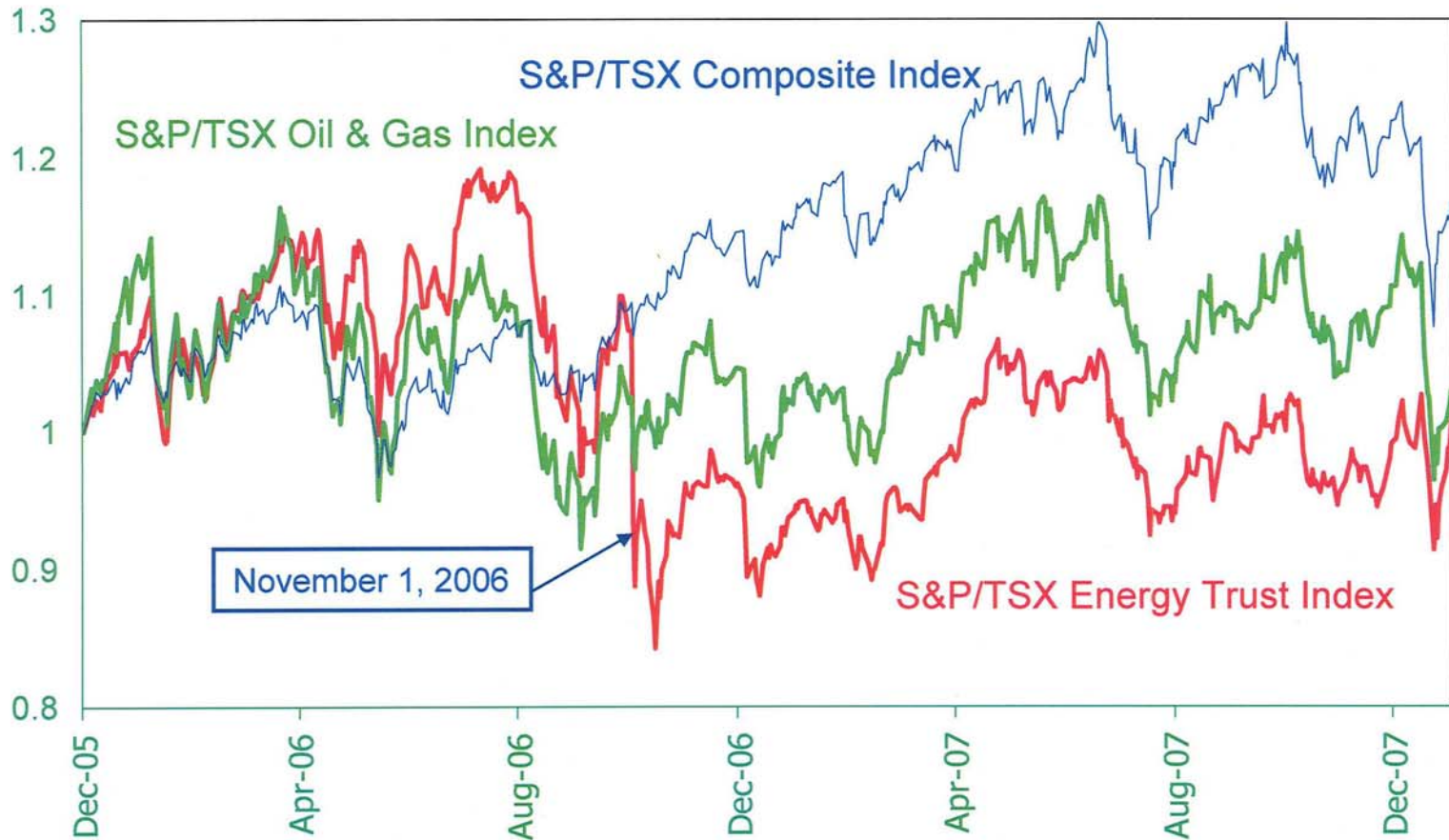
to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

S&P/TSX Energy Trust Index vs. S&P/TSX Oil & Gas Index January 1, 2006 to January 31, 2008

Relative
Strength

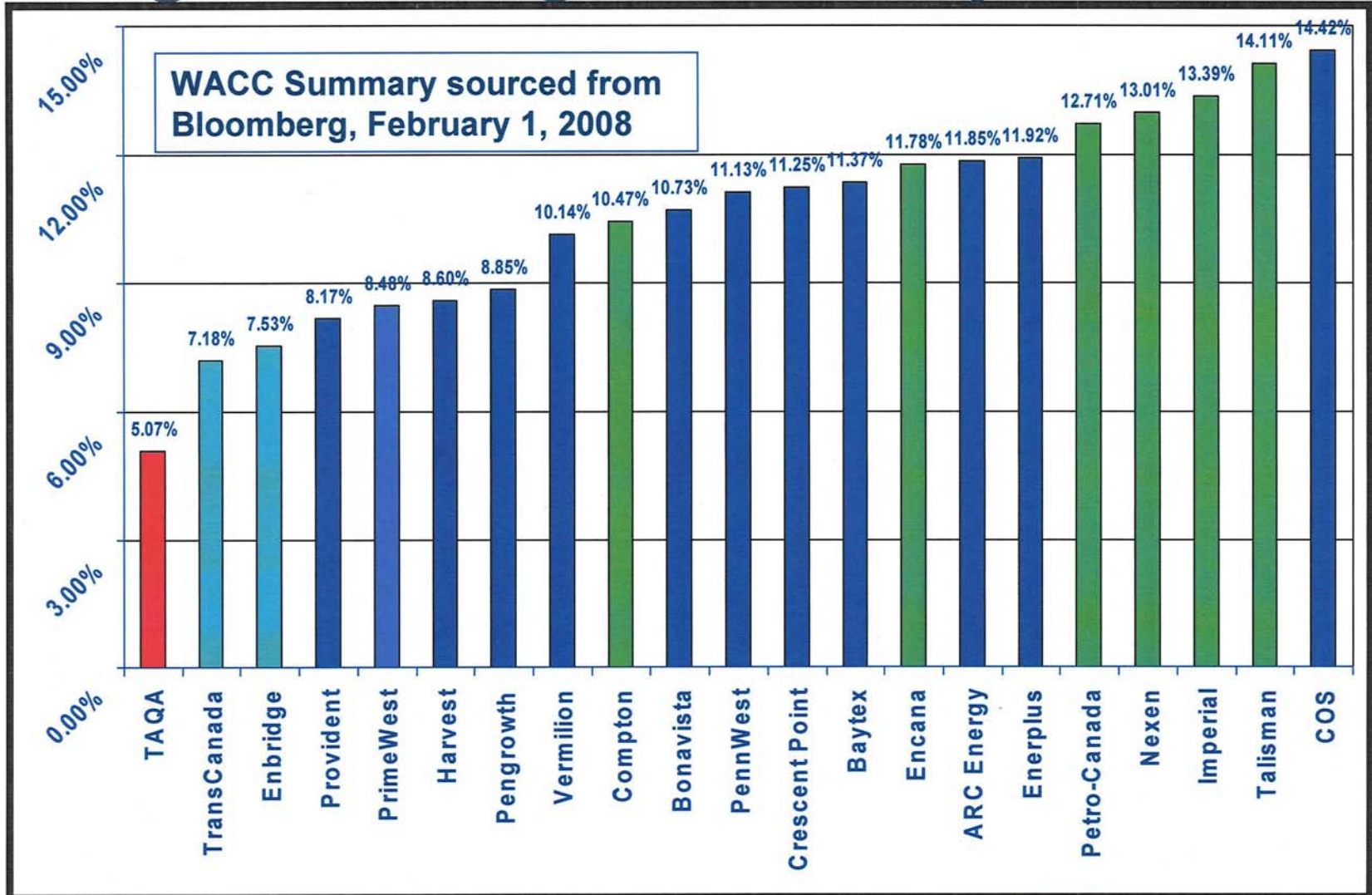


to January 31, 2008



CANADIAN ASSOCIATION
OF INCOME FUNDS
L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU

Weighted Average Cost of Capital



CAIF

CANADIAN ASSOCIATION
OF INCOME FUNDS

L'ASSOCIATION CANADIENNE
DES FONDS DE REVENU