TORONTO PORT AUTHORITY

MANAGEMENT'S DISCUSSION & ANALYSIS – 2012

(in thousands of dollars)

May 27, 2013

Management's discussion and analysis (MD&A) is intended to assist in the understanding and assessment of the trends and significant changes in the results of operations and financial condition of the Toronto Port Authority for the years ended December 31, 2012 and 2011 and should be read in conjunction with the audited financial statements and accompanying notes.

Summary

The Toronto Port Authority ("Port Authority"or "TPA") continued to grow its profitability in 2012. Growth in profitability has been achieved in each of the last five years. Net Income from Operations was $19,802 in 2012, up from $15,417 in 2011, with overall Comprehensive Income of $19,589, compared to $13,962 in 2011.

In 2012, all four of the main business areas of the Toronto Port Authority were profitable on an operating basis, with improved profitability over 2011. This is shown on page 33, Note 17, of the 2012 Audited Financial Statements.

This is the second year that the Port Authority has presented its financial statements under International Financial Reporting Standards ("IFRS"). The accounting policies set out in Note 2 of the 2012 Audited Financial Statements have been applied in preparing the financial statements for the year ended December 31, 2012, and in the comparative information presented in these financial statements for the year ended December 31, 2011.

Introduction

The TPA was incorporated on June 8, 1999 as a government business enterprise under the *Canada Marine Act* as the successor to The Toronto Harbour Commissioners.

The Toronto Port Authority is responsible for operating the lands and harbour it administers in the service of local, regional and national social and economic objectives, and for providing infrastructure and services to marine and air transport to help realize these objectives.

The TPA is an important part of the Southern Ontario Gateway as it is one of five ports of significance in the province, while the Billy Bishop Toronto City Airport ("BBTCA" or "Airport") is one of four airport facilities in the region with the capability to provide international service. In this regard, the TPA is and will remain an important factor in the economic health of Southern Ontario.

The main operations of the Port Authority are Port Operations, the Outer Harbour Marina ("OHM"), the BBTCA and Property/Rental.

The TPA owns and operates Marine Terminal 51 and Warehouse 52 ("Marine Terminals") located at the foot of Cherry Street and has contracted with Logistec Stevedoring Inc. to manage this operation. The TPA also owns the International Marine Passenger Terminal ("IMPT"), which currently services the cruise ship industry and has been used as a location for film productions.

The TPA continues to pursue a construction products distribution initiative whereby the Marine Terminals would be a central distribution and storage hub for products used in the construction of buildings and infrastructure. This would offer quick turn-around for the supply of products on a just in time basis and would generate environmental benefits from the close proximity of the facility to major construction projects in Toronto.

With a solid economy and a growing population in Toronto and surrounding areas, there is renewed interest in the Port of Toronto. There are several projects related to transportation and infrastructure that the Port Authority is pursuing in 2013.

For the Outer Harbour Marina financial performance remains positive and consistent. Demand for winter storage remained strong in the 2012-2013 winter season and summer berthing renewals also remain strong. Low interest rates continue to create an inducement encouraging consumers, led by people aged 45 to 65, to buy more and bigger recreational boats. New technology in both the power and sail categories is making it much easier for novice boaters to buy bigger boats. This is important as the Port Authority has just finished replacing its smaller twenty year old docks with an inventory of larger boat slips and has been considering plans to build Phase II of the Marina, adding 435 new larger slips, in the forty to fifty foot range.

The Billy Bishop Toronto City Airport has a competitive advantage in the market that includes Toronto-Pearson, Hamilton and Buttonville. Its close proximity to downtown Toronto provides time sensitive, environmentally conscious travelers the convenience and service they demand.

According to an Economic Impact Study released in November 2012 conducted by Intervistas Group, a leading management consulting company, the BBTCA generates $1.9 billion in annual economic output and 5,700 jobs, which includes 1,700 directly associated with the Airport and plays a "significant role in providing critical regional and continental transportation linkages to support and grow Toronto's economy." The report was released jointly by the Toronto Port Authority and the Toronto Board of Trade.

Pedestrian Tunnel to Airport (Please see Note 16 (a) in the 2012 Audited Financial Statements)

On March 8, 2012, financial close was achieved with a “preferred proponent” Forum Infrastructure Partners to design, build, finance, operate and maintain a Pedestrian Tunnel under the Western Channel between the mainland and the Airport, modeled after a Public Private Partnership (“P3”) procurement process. The Project Agreement is in the form of a Concession Agreement wherein the Port Authority will make Monthly Service Payments ("ASPs") to Forum using a portion of the $20.00 Airport Improvement Fee collected from Enplaning (departing) Passengers at the Airport. For comparison purposes, each passenger at Pearson International Airport currently pays an AIF of $25.00 per departure.

The construction cost of the Pedestrian Tunnel is contracted at $82.5 million and it is expected to be substantially complete by mid-2014. Ownership title to the Pedestrian Tunnel remains with the Port Authority throughout the term of the Agreement.

The cumulative amount incurred to the end of December 31, 2012 on the Pedestrian Tunnel was $43,888 (2011- $4,060) and is included under Capital Assets as work-in-progress.

Payments to the Government Stakeholders

The TPA annually pays a charge on Gross Revenue to the federal government based on the calculated gross revenue in each fiscal year. For 2012, the amount paid to the federal government was $2,368 (2011-$1,930). In addition, the TPA pays Payments-in-lieu of Taxes (“PILTs”) to the City of Toronto. The PILTs amount accrued and paid for 2012 was $2,137 (2011-$2,210). The amounts paid to the federal government and to the City of Toronto together total $4,505 in 2012 and $4,140 in 2011.

Fiscal Period – January 1 to December 31, 2012 versus 2011

Consolidated Statement of Operations and Comprehensive Income (Financial Statements – Page 3)

Revenues totaled $49,578 in 2012, an increase of $7,358 over 2011 Revenue of $42,220. Expenses increased by $2,973 in 2012 versus 2011, from $26,803 to $29,776. The 2012 Net Income from Operations and Airport Improvement Fees ("AIF") for the Toronto Port Authority ("TPA") was $19,802, an improvement of $4,385 over the 2011 operating profit of $15,417. This is before Payments in Respect of Land Disposition and Payments in Lieu of Taxes. This is also before the Gain/(Loss) on Interest Rate Swap and the Loss Due to Impairment of Capital Assets. There were several reasons for the improvement in operating results in 2012, explained below in the different sections of the analysis.

Revenues reported as Port, Outer Harbour Marina, Airport, Property and Other were $31,711 in 2012 versus $27,575 in 2011, an increase of $4,136. The main source of the increase was the Airport with a year over year increase of $3,132. Also, Port Operations were higher by $747. These two areas accounted for 94% of the approximate 15% increase in revenue, year over year.

In Expenses, Wages, Salaries and Employee Benefits were $9,979 in 2012, higher by $2,094 over 2011. The Airport was $1,457 higher due to additional operational and administrative hirings, as Airport volumes continued to increase. Port Operations was higher by $524 due primarily to bulk cargo handling in the latter half of the year.

Repairs and Maintenance for the Port Authority remained relatively flat, with a small decrease of $231, from $3,694 in 2011 to $3,463 in 2011.

Professional and Consulting Fees fell by $64 in 2012 to $ 1,877, as a trend in lower professional fees continued.

Amortization increased in 2012 over 2011 by $286, as additional assets are being brought into use and amortized at the Airport.

Other Operating and Administrative Expenses were up by $450 in 2012 from 2011, to $10,250. This increase was driven primarily by Operating costs at the Airport, mainly due to alternative parking arrangements and utility costs at the Airport..

Please refer to page 33, Note 17 as a reference for the following discussion.
(The Analysis presented below is the form of discussion included in prior year's MD&A)

The major reason for the improved result in 2012 came again from the Billy Bishop Toronto City Airport. Driven by a continuing increase in revenues, both in Operating and Airport Improvement Fees, the Airport generated an operating profit of $6,218 in 2012 and $4,543 in 2011, and an overall profit of $24,085 and $19,188 in 2012 and 2011, respectively, when AIF revenue is included. This growth trend at the Airport is expected to continue in 2013 although on a flatter curve than in prior years. Enplaned and deplaned passengers in 2012 totaled 1,909,364[1] versus 1,548,376[1] in 2011, without including connecting passengers. With connecting passengers included the numbers for enplaned and deplaned passengers are 2,291,574[1] and 1,845,282[1] in 2012 and 2011, respectively. It should be noted that the Airport Improvement Fees are restricted revenues that can only be utilized for Airport capital projects and expenditures.

The operating bottom line for Port Operations was Net Income of $1,392 in 2012. This compares favourably to a profit or Net Income from Operations of $1,169 in 2011. Total Port tonnage was 1,861,082[1] in 2012 versus 1,775,162[1] in 2011, an increase of 5%. This was due primarily to the sugar handling and loading operations at the TPA's Marine Terminals.

The Outer Harbour Marina continued its steady performance, with an operating profit of $1,280, an increase of $89 over the operating profit of $1,191 in 2011.

Property and Other accounted for an operating profit of $153 in 2012, an increase of $94 versus 2011.

Investment Income was $482 in 2012 versus $269 in 2011. Corporate Services expenses were up $693 and the Charge on Gross Revenue increased by $438.

A decrease in the Payments in Respect of Land Disposition of $68, a small decrease of $73 in Payments in Lieu of Taxes due to an adjusted accrual, a Gain in the Interest Rate Swap of $1,023 and a Loss Due to Impairment of Capital Assets of $350 in 2011 accounted for the remaining change in the overall bottom line. Net Income increased from $13,921 in 2011 to $19,684 in 2012, an increase of $5,763, or 41%. Comprehensive Income increased from $13,962 in 2011 to $19,589 in 2012.

<u>Port Operations</u>

Port revenues are generated from the operation of the Marine Terminals and include terminal handling charges, container services, terminal berthing and ships services. In addition, revenue is generated from the IMPT, including charges for cruise ships and filming. From waterside, there are Harbour User Fees paid by Tour and Charter boats and Cargo Dues paid by large industrial ships. Finally, the Works & Environmental Services department generates revenue from services provided to Port users and other general customers.

Port revenue was up in 2012 by $747 versus 2011, as Terminal Handling Fees were higher at the TPA's Marine Terminal operation from bulk sugar operations. Also, storage of cargo revenues were higher in 2012.

Port expenses increased in 2012 over 2011 by $524 primarily due to increased bulk handling activity at the Marine Terminals and in Works Services.

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[1] *Actual number, not rounded to the nearest thousand.*

Outer Harbour Marina ("OHM")

The occupancy rate for summer berthing at the OHM remained at 95% in 2012 and stayed at 100% for winter storage. The annual turnover rate remained the same in 2012 at approximately 3% for summer contracts.

In addition to berthing and storage, marina services include shore power, pump-outs, power wash, fresh water and the sale of fuel and other products. There is also a 50-ton travellift for haul out and launch, and masting/demasting services.

Revenues at the Outer Harbour Marina were up $236, as berthing revenues, winter storage and fuel sales increased in 2012 versus 2011. A trend towards larger boats as well as rate increases continue to push revenues higher, as customers pay fees based on the greater of Slip Length and Overall Length of Boat.

Expenses were up $147 from 2011 to 2012, an increase of 9%. Salaries, Wages and Benefits, Cost of Fuel and Consulting costs were all higher.

Billy Bishop Toronto City Airport ("Airport")

In 2012, operations at the Airport continued to grow; with the completion of the sixth full year of operations by Porter Airlines and a full year of Air Canada – Sky Regional. The two main revenue sources at the Airport are the Airport Operating Fees charged based on slot allocation and usage and Airport Improvement Fees ("AIF"), currently at $20.00, collected from enplaning/departing passengers. The Airport Improvement Fee is funding the Airport's ongoing capital expenditure program, including debt service on the existing Bank Loans.

The increase in passenger volumes and Airport activity continued to drive Airport revenues higher, with 2012 revenue at $38,720 versus $32,366 in 2011, a $6,354 improvement. The number of Enplaned Passengers paying AIF in 2012 was 950,500, up from 780,666 in 2011, or 22%.

On the expense side, there was an increase of $1,457 in 2012, due primarily to increases in Salaries, Wages and Benefits, Operating Materials and Consulting, partially offset by decreases in Maintenance and Repairs, Legal Fees and Security costs.

Property and Other

Revenues from ancillary property holdings and other sources, such as filming, were lower in 2012, decreasing by $192, due to the loss of rental revenue as a tenant left 60 Harbour Street and the loss of revenue from the surface parking lot at 90 Harbour Street, as a result of property development. Properties leased out included two floors in 60 Harbour Street, Pier 6, 5 Queen's Quay West, as well as a surface Parking Lot at 30 Bay Street.

Expenses decreased $286 in 2012 over 2011, due primarily to reduced Legal Fees and Operating costs related to property operations, partially offset by higher Property Taxes in 2012.

Investments

Investment Income increased by $213 in 2012 versus 2011, as Interest on general investment holdings was higher in 2012, with the higher cash and investment positions.

Corporate Services

Corporate Services support the operations of the Toronto Port Authority by providing general administrative support and services. These include executive, finance, accounting, human resources, communications, information technology, legal, risk management, promotion and the functioning of the Board of Directors. General expenses, related to TPA, but not related to any particular operation are assigned to Corporate Services.

Expenses in Corporate Services increased in 2012 by $693, compared to 2011. Legal Services were brought in-house in 2012. In addition, Legal and Consulting Fees were incurred in preparation for the PILTs Dispute Advisory Panel in early 2013. Additional Public Affairs expenses were also incurred in 2012, as TPA continued to support and make investments in the harbour community.

Payments in Respect of Land Disposition

These amounts are the Operating Payments from the City Settlement Agreement and were lower in 2012 by $68 due to additional rental amounts received for leased land at the eastern end of the Ship Channel. The $68 is reported in the Port Operations revenue line.

This stream of payments ceased in 2012 pursuant to the City Settlement Agreement.

Payments in Lieu of Taxes ("PILTs") (Please see Note 10 in the 2012 Audited Financial Statements)

The amount of $2,137 accrued for 2012 for PILTs to the City of Toronto represents the amount determined by the TPA to be fair and reasonable. The total amount accrued for 2011 and 2012 inclusive as at December 31, 2012 was $4,347. In total the Toronto Port Authority has paid the City of Toronto $13,240 in PILT payments for 1999 to 2012, inclusive. Of the eighteen Port Authorities in Canada, the TPA pays one of the highest PILTs amounts as a percentage of gross revenue.

City Council recently rejected a Per Passenger PILT of $0.94029 for the Billy Bishop Toronto City Airport. This is the same Per Passenger amount that Pearson Airport pays its host municipalities, which in part includes the City of Toronto, pursuant to provincial legislation. In the absence of an acceptable settlement offer from the City of Toronto, the matter will proceed to a federal Dispute Advisory Panel.

Gain/(Loss) on Interest Rate Swap

The TPA has been following hedge accounting rules on a "critical terms match" basis under GAAP. Under IFRS, the Swap was reevaluated and did not meet IAS 39 requirements in terms of necessary documentation and testing/assessment in 2010 and 2011. The unamortized accumulated other comprehensive loss due to losses in derivatives previously designated as cash flow hedge as at December 1, 2009 was $1,087. This loss is being amortized over the remaining term of the Swap until maturity on January 4, 2022. The total impact of gains and losses on derivatives including amortization in 2012 was (Gain 2012 - $207) (Loss 2011 - $816)

Loss Due to Impairment of Capital Assets

Capital assets which have long lives and are non-financial in nature are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. When the recoverable amount of an asset is estimated to be less than the carrying amount, the carrying amount is reduced to the recoverable amount and an impairment is recognized. In 2011, the Port Authority recognized $350 in impaired assets.

Consolidated Statement of Changes in Equity (Financial Statements – Page 4)

The Statement of Changes in Equity had an opening balance in Equity on January 1, 2011 of $49,523, which included an Accumulated Other Comprehensive loss of $720. The ending balance as at December 31, 2011 included the Net Income for the year of $13,921, plus Amortization of the Accumulated Loss on Derivative Interest of $91, plus the Unrealized Gain on Available for Sale Assets of $41, for a closing Equity balance as at December 31, 2011 of $63,576. The Amortization of $91 is included in the Loss on Interest Rate Swap in the Statement of Operations and Comprehensive Income.

The ending balance as at December 31, 2012 included the Net Income for the year of $19,684, plus Amortization of the Accumulated Loss on Derivative Interest of $91, plus the Unrealized Loss on Available for Sale Assets of $105, plus the Gain on Interest Rate Swap-Effective portion of $10, for a closing Equity balance as at December 31, 2012 of $83,256. The Amortization of $91 is included in the Loss on Interest Rate Swap in the Statement of Operations and Comprehensive Income.

Consolidated Statement of Financial Position (Financial Statements – Page 5)

Cash and Cash Equivalents and Short-term Investments are separated into two groups, one being assets that are not restricted in use as to Business Unit, and the other, identified as AIF Restricted that can only be used for Capital Expenditures at the Billy Bishop Toronto City Airport. Cash and Cash Equivalents and Short-term Investments have gone from $21,015 at the end of 2011 to $25,789 as at December 31, 2012, an increase of $4,774. Cash and Cash Equivalents and Short-term Investments that are AIF Restricted have gone from $14,554 at the end of 2011 to $12,589 as at December 31, 2012, a decrease of $1,965. An analysis of the Statements of Cash Flows is included below.

(in thousands of dollars)

Accounts Receivable increased from $6,062 at the end of 2011 to $6,239 at the end of 2012. The details of the increase are found on Page 17, Note 3 to the Audited Financial Statements. There was an increase in Trade Receivables of $1,114 at year end, 2012 versus 2011, due to larger revenue accruals at the end of 2012. Offsetting this overall increase is a decrease in Accounts Receivable of $871 for the Airport Capital Assistance Program and a decrease in Mortgage Receivable of $66.

Comparing December 31, 2012 to December 31, 2011, Inventories were lower by $17 and Prepaid Expenses increased by $9.

The details of the Long-Term Investments are found on Page 17, Note 4. These investments will mature in 2013 and 2014.

The details on Capital Assets are found on Page 22 and 23, Note 7. Capital Assets increased by $48,260 in 2012 and on a Net Book Value basis the increase was $45,113, when amortization, outside funding for capital projects and impairments are taken into account.

The details of the gross increase are as follows:

Pedestrian Tunnel Project	$39,828
Port Operations	$1,085
Outer Harbour Marina	$3,326
Billy Bishop Toronto City Airport	$2,743
Property & Other	$1,278
Total	$48,260

In addition to the Pedestrian Tunnel Project shown above, larger Capital Expenditures in 2012 included rehabilitation of the Ship Channel Bridge, the second stage of a three-stage project to replace Floating Docks at the Outer Harbour Marina (“OHM”), a Temporary Indoor Storage Facility at the OHM, development of the Canada Malting Site, completion of the North Engine Noise Barrier at the Airport and the partial completion of the Leslie Street Landfill Fish Habitat Project.

Amortization allocated to the operations over the years is deducted from the Capital assets, as well as amounts received for capital funding from various sources. Losses due to impairment also reduce the Gross Book Value of Capital Assets.

Accounts Payable and Accrued Liabilities have increased by $825, from 2011 to 2012. This is due to an Airport Operating Fee Refund for 2011 that is to be paid back to Scheduled Carriers at the Airport. Also there is an increase in the Charge on Gross Revenue to be paid to Transport Canada, partially offset by a decrease in Trade Payables for equipment purchases and operations.

The Fair Value of the Interest Rate Swap represents the closing balance following the gain in value in 2012 of $308.

The current portion of the Bank loan is the principal amount to be repaid in the next fiscal year, in this case 2012.

The liability for Payments in Lieu of Taxes is the amount recognized as payable to the City of Toronto. Page 28 and 29, Note 10 describes the status of the PILTS situation.

Unearned Revenue increased by $193, 2012 versus 2011. This liability records the amount of Unearned Marina revenue the Port Authority will provide to customers, by way of services in the upcoming year, as well as Unearned Harbour Permits and Unearned Rents.

The Bank Loans are described on Page 27, Note 9 (a).

The Pedestrian Tunnel Concession Liability is described on Page 32, Note 16 (a). As at December 31, 2012, the Pedestrian Tunnel Project was 38% complete and an asset of $36,187 has been included as part of the Capital under work in progress. The related liability as of December 31, 2012 was $29,050.

Deferred City Capital Payments are payments made to the Port Authority by the City of Toronto pursuant to the 2003 Settlement Agreement that have not yet been spent on capital. In 2012, an additional $1,700 in Capital Payments was received by the Port Authority. The net amount recognized by the Port Authority for capital for these funds in 2012 was $1,308, so the difference between amounts received $1,700 and the funds recognized for Capital was $392, which represents the net change in the Deferred City Capital Payments from $4,972 in 2011 to $5,364 in 2012.

Employee Benefit Liabilities represents the liability recognized for Port Authority Benefit Plans and are described on Pages 24 to 26, Note 8.

Equity represents the difference between Assets and Liabilities. Equity increased in 2012 by $19,680, as detailed on the Statements of Changes in Equity on Page 4.

Consolidated Statement of Cash Flows (Financial Statements - Page 6)

The Statements of Cash Flows begins with the Net Income reported in the Statement of Operations and Comprehensive Income and adds back any non-cash items. These include Amortization, Employee Future Benefit Expense, Loss Due to Impairment of Capital Assets, Interest Expense offset by Bank Interest Paid and the (Gain)/Loss on the Derivative Designated as a Cash Flow Hedge.

An amount is then added or deducted for non-cash working capital. In 2012, this amount resulted in an increase in cash of $2,986. This was due to an increase in in Accounts Payable and Accrued Liabilities of $825, an increase in Payments in Lieu of Taxes of $2,137, a decrease in Inventories of $17, an increase in Unearned Revenue of $193, offset by an increase in Accounts Receivable of $177 and an increase in Prepaid Expenses of $9.

Investing Activities and Financing Activities are then listed. Investing Activities include a decrease in the Mortgage Receivable and Long-term Investments, an increase in Short-term Investments and the Acquisition of Capital Assets listed above. Financing Activities include items related to Pedestrian Tunnel Project, the Bank Loan, amounts in settlement payments received from the City Settlement Agreement, amounts to be received under the Airport Capital Assistance Program and other Funded capital.

The end result is the Cash and Cash Equivalents position decreased in 2012 by a total of $7,843 from $19,430 to $11,587. The balance as at December 31, 2012 is a combination of Cash and Cash Equivalents – TPA $10,581 and Cash and Cash Equivalents – AIF Restricted $1,006. The TPA continues to invest its cash resources into infrastructure improvements that benefit all of its business operations.

30 Bay/60Harbour Street Redevelopment Project

The Toronto Port Authority is working on reaching various agreements with Oxford Properties Group for the redevelopment of the 1.8 acre site on the northwest corner of Bay and Harbour Streets. The property is anchored by the landmark Toronto Harbor Commission building at 60 Harbour Street, which will be maintained and preserved.

Oxford and TPA will work to formalize the business arrangements over the next few months. TPA plans to have construction commence within the next few years following required approvals and site planning.

Board of Directors Governance

The TPA is governed by a nine member Board appointed as per subsection 14 (1) of the Canada Marine Act, and as per section 4.6 of the Letters Patent issued to the Toronto Port Authority. There are four appointments by the user groups, three appointments by the Governor-in-Council, one by the Province of Ontario and one City of Toronto appointment to the Board of Directors. There are five (5) Committees of the Board of Directors, namely the Board Executive Committee, the Audit & Finance Committee, the Governance, Nominating & Human Resources Committee, the Communications & Outreach Committee and the Pension Committee.

The Chairmanship of the Board of Directors remained unchanged throughout 2012, with Mr. Mark McQueen in the position since January 21, 2009.