TORONTO PORT AUTHORITY
(Doing Business as PortsToronto)

MANAGEMENT'S DISCUSSION & ANALYSIS – 2017
(In thousands of dollars)

May 3, 2018

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, doing business as PortsToronto (the "Port Authority" or "TPA") for the years ended December 31, 2017 and 2016 and should be read in conjunction with the 2017 Audited Financial Statements (the "Financial Statements") and accompanying notes.

Summary

The Port Authority continued to be profitable in 2017. Net Income (excluding the gain on the sale of the 30 Bay Street/60 Harbour Street Property) for the year was $6,368, slightly down from $6,684 in 2016. This MD&A will discuss the reasons for changes in Net Income year over year, as well as highlight other areas impacting the Port Authority's financial performance in 2017.

The Port Authority presents its financial statements under International Financial Reporting Standards ("IFRS"). The accounting policies set out in Note 2 of the Financial Statements have been applied in preparing the Financial Statements for the year ended December 31, 2017, and in the comparative information presented in these Financial Statements for the year ended December 31, 2016.

Introduction

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

The 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 facilitate these objectives.

The Port Authority is structured around three priority focus areas from a sustainability perspective, as follows:

- Environmental Stewardship
- Community Engagement
- Economic Performance

Through its commitment to fostering strong, healthy and sustainable communities with investments of more than $10 million since 2009 in donations, sponsorships and in-kind contributions to community initiatives, activities and events, the Port Authority is dedicated to environmental, social and governance factors ("ESGs") that are very important to a port authority operating in a burgeoning community.

The Port Authority's main business areas are Port Operations, the Outer Harbour Marina ("Marina"), Billy Bishop Toronto City Airport ("BBTCA" or the "Airport") and Property/Other.

The TPA owns and operates a 56-acre port facility at 8 Unwin Avenue (the "Port Facility"), that includes a 126,000 square foot Warehouse ("WH-52"). This site also houses Marine Terminal #51, which is in the process of being converted to a film and production studio, under a lease between TPA and Cinespace Film Studios ("CFS"). The Port Facility also houses Cruise Ship Terminal ("CST"), which currently services the cruise ship industry and has been used as a location for film productions and event space. A portion of the CST is also being leased to CFS for film production.

The TPA continues to promote mixed use at its port facility including bulk handling and storage, general and project cargo, as well as container packing and unpacking services. With its preferred location and a growing population in Toronto and surrounding areas, the Port Authority will continue to pursue additional opportunities around the construction industry for its Port facility in 2018.

In 2017, 2.173 million metric tonnes of cargo moved through the Port of Toronto, a record amount over the last ten years for marine activity in the City of Toronto. There were 201 ships visits, bringing sugar, salt, cement and aggregate directly to the heart of the City, bypassing road congestion along the way. At 2.173 million metric tonnes, overall port tonnage was up 15.9%, comparing 2017 to 2016. In addition to traditional marine cargo, the Port of Toronto is a growing cruise ship destination, with 16 cruise ships bringing a total of 5,695 passengers to visit Toronto via the CST in 2017.

The financial performance of the Outer Harbour Marina remains positive and consistent. Demand for winter storage, which includes two heated indoor storage facilities, remained strong in the 2017-2018 winter season and summer berthing renewals also remain strong. Low interest rates continue to create an inducement by 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 operate larger boats. This is important as the Port Authority replaced its smaller twenty year old docks with an inventory of larger boat slips. Despite record high water levels in the summer of 2017, the Marina managed to remain open for business and had a successful season, due in large part to the new dock installations.

Billy Bishop Toronto City Airport is Canada's ninth-busiest airport and welcomed 2.766 million business and leisure travelers in 2017. This was up from 2.724 million in 2016. The Airport is Canada's sixth busiest in terms of passenger service to the United States. BBTCA's close proximity to downtown Toronto and introduction of the Pedestrian Tunnel on July 30, 2015 provides time sensitive travelers the predictable convenience and service they demand.

BBTCA is an important international gateway and a key driver of Toronto's economy, generating more than $470 million in Gross Domestic Product (GDP) and supporting 4,740 jobs, including 2,080 directly associated with airport operations.

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 (the "BBTCA" or "Airport") is one of the key members of the 11 Airport Southern Ontario Network (Toronto Pearson International Airport; Billy Bishop Toronto City Airport; Hamilton John C. Munro International Airport; Kingston/Norman Rogers Airport; Lake Simcoe Regional Airport; London International Airport; Oshawa Executive Airport; Niagara District Airport; Peterborough Airport; Region of Waterloo International Airport; Windsor International Airport) with the capability to provide international and regional service and with a focus in several key aviation areas. In this regard, the TPA is and will remain an important factor in the economic health of Southern Ontario.

Financial Considerations
Pedestrian Tunnel to the Airport (Please see Note 14 in the 2017 Audited Financial Statements)

On March 8, 2012, the Port Authority entered into a Project Agreement for the design, build, finance, operation and maintenance of a pedestrian tunnel (the "Pedestrian Tunnel") under the Western Channel linking mainland Toronto to the Airport. The project is in the form of a twenty-year concession agreement wherein the Port Authority makes monthly service payments ("MSPs") using a portion of the Airport Improvement Fee ("AIF") collected from enplaning (departing) passengers at the Airport. Effective, April 1, 2018, the AIF has been reduced from $20.00 to $15.00 per departure. For comparison purposes, each passenger at Toronto Pearson currently pays an AIF of $25.00 per departure. In addition, Toronto Pearson charges a connecting passenger fee of $4.00 per passenger, while BBTCA currently does not have a connecting passenger fee.

The base construction cost of the Pedestrian Tunnel was $82,500 and it was substantially complete and accepted by the Port Authority on May 29, 2015. The Tunnel was officially opened to the public and stakeholders on July 30, 2015. Ownership of the Pedestrian Tunnel is vested in the Port Authority.

The capital asset value recorded as at December 31, 2017 on the Pedestrian Tunnel was $110,418, with a related liability of $68,095. The capital asset includes the construction cost, as well as other costs such as engineering, legal, consulting and financing costs.

The comparative operating costs of the Pedestrian Tunnel included in the Airport Business Unit Expenses in Note 16, between 2017 and 2016, were $9,965 and $10,160 respectively.

Sale of 30 Bay/60 Harbour Street Property (Please see Note 15 in the 2017 Audited Financial Statements)

On May 1, 2017, the Toronto Port Authority sold its 1.8 acre site at 30 Bay Street and 60 Harbour Street to Oxford Properties Group ("Oxford") and Canada Pension Plan Investment Board ("CPPIB"). The transaction price was agreed at $96,000, a portion of which will be paid over three years from the date of closing.

In connection with the sale, the previously announced contribution agreement with Oxford and CPPIB was terminated and $1,662 owing to Oxford was paid upon the closing of the sale transaction.
The historic Toronto Harbour Commission building located on the site will be restored and maintained as part of any future development plan.

Internal Reserve

In early 2017, the Port Authority decided to establish a reserve for the proceeds of the 30 Bay Street/60 Harbour Street Property sale transaction, in which the proceeds would be allocated to various accounts and uses. The purpose was to internally allocate the funds for prudent use on capital projects, business securitization and debt retirement.

As at December 31, 2017, the amounts allocated to the reserve are included in cash and cash equivalents of $23,642 (2016 - $Nil) and short-term investments of $35,438 (2016 - $Nil).

Payments to Government Stakeholders

The TPA annually pays a charge on its gross revenue to the federal government based on the calculated gross revenue in each fiscal year. For 2017, the amount paid to the federal government was $3,029 ($3,294 in 2016). In addition, the TPA pays Payments-in-lieu of Taxes (“PILTs”) to the City of Toronto. The PILTs paid by TPA in 2017 was $3,275 ($3,249 in 2016). The amounts accrued and paid to the federal government and to the City of Toronto together total $6,304 for 2017 and $6,543 for 2016, representing 10.4% and 11.0% of the Port Authority’s Operating Revenue in fiscal years 2017 and 2016 respectively.

Board of Directors Governance

The TPA is governed by a Board of Directors appointed by three levels of government as per subsection 14 (1) of the *Canada Marine Act*, and section 4.6 of the TPA’s Letters Patent. Six directors are appointed by the Governor-in-Council as nominated by the Minister of Transport in consultation with the user groups, one director is appointed by the Governor-in-Council as nominated by the Minister of Transport, one director is appointed by the Province of Ontario and one director is appointed by the City of Toronto. There are four (4) Committees of the Board of Directors, namely the Audit & Finance Committee, the Governance & Human Resources Committee, the Communications & Outreach Committee and the Pension Committee. The Chairmanship of the Board of Directors changed in 2015, with Mr. Robert Poirier elected as chair as of August 20, 2015. Mr. Poirier remains the Chair as of the date of this Report.

Fiscal Period – January 1 to December 31, 2017 versus 2016

Consolidated Statement of Operations & Comprehensive Income (Financial Statements-Page 3)

Revenues totaled $60,792 in 2017, an increase of $1,096 over 2016 revenue of $59,696. Expenses increased by $1,402 in 2017 versus 2016, from $49,893 to $51,295.

Revenues reported as Port Operations, Outer Harbour Marina, Airport, Property and Other, not including the Airport Improvement Fees, were $39,842 in 2017 versus $38,933 in 2016, an increase of $909. The main source of the increase was Airport revenue, with a year over year increase of $868. Port Operations was higher by $134, the Marina higher by $357 and Property lower by $900. Investment Income was higher by $450. Property revenue decreased from 2016 with the sale of the 30 Bay/60 Harbour Street Property on May 1, 2017.

Wages, Salaries and Employee Benefits Expenses were $11,975 in 2017, higher by $126 versus 2016. Overall increases were mainly due to hiring of staff at the Port Operations, Marina and Corporate departments. Repairs and Maintenance for the Port Authority increased in 2017 by $1,347, from $6,740 in 2016 to $8,087 in 2017, as all operations were impacted by record high water levels and other non-routine events in 2017.

Professional and Consulting Fees increased by $586 in 2017 to $2,228, mainly due labour matters across all business operations.

Amortization increased in 2017 over 2016 by $330, Interest Expense was up by $128 in 2017 versus 2016, PILTs were higher in 2017 by $26.

Please refer to page 35, Note 16 as a reference for the following discussion.

In 2017, all four main business units of the Toronto Port Authority were profitable. Included in Net Income from Operations are the AIF collected from enplaning/departing Airport passengers. The number of enplaned and deplaned passengers combined (not including connecting passengers) increased by 1.4% in 2017, from 2016. It should be noted that the AIFs are restricted revenues that can only be used for Airport capital projects and expenditures. Included under Airport expenses are interest and amortization related to the Tunnel and other Airport capital expenditures.

The operating bottom line for Port Operations was Net Income of $580 in 2017. This was lower than 2016 by $653, as Storage revenues, Ship Services and Filming revenues were lower in 2017, offset by higher Terminal Handling, Passenger User Fees, Cargo Dues and Berthing. Expenses were higher due to Repairs and Maintenance costs caused by various non-routine events, such as high water levels. Total Port tonnage was 2,172,750[1] in 2017 versus 1,874,035[1] in 2016, an increase of 15.9%, due to higher salt, stone and sugar tonnages coming into Port, offset by lower cement and aggregate cargoes.

The Outer Harbour Marina continued its steady performance, with an operating profit of $1,496, an increase of $264 from the operating profit of $1,232 in 2016.

Property and Other accounted for an operating profit of $570 in 2017, a decrease of $366 versus 2016. This was mainly due to loss of rental income with the sale of the 30 Bay/60 Harbour Street Property.

Investment Income was $622 in 2017, an increase of $450 from $172 in 2016. This was due to investment income earned on the proceeds from the sale of 30 Bay/60 Harbour Street Property.

Corporate Services expenses were up $407 and the Charge on Gross Revenue decreased by $265. The increase in Corporate Services expenses related to additional rent paid by the Port Authority for its tenancy at 60 Harbour Street.

There was a Gain on the Interest Rate Swap of $146. Net Income (excluding the gain on the sale of the 30 Bay/60 Harbour Street Property) was $6,368 in 2017 versus $6,684 in 2016, a decrease of $316. Comprehensive Income increased from $11,244 in 2016 to $96,817 in 2017, which includes the gain on the property sale.

<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 Cruise Ship Terminal, including charges for cruise ships services, filming and event space. 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 2017 by $134 versus 2016, as Terminal Handling Fees, Passenger User Fees, Cargo Dues and Port Berthage Charges were higher; offset by lower Storage of Cargo, Ship Services and Filming revenues. Port expenses increased in 2017 versus 2016 by $787, primarily due to higher Repairs and Maintenance costs caused by various non-routine events, such as record high water levels.

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1 *Actual numbers, not rounded to the nearest thousand.*

Outer Harbour Marina

The occupancy rate for summer berthing remained at just under 85% in 2017 and stayed at 100% for winter outdoor and indoor storage. The annual turnover rate remained low in 2017.

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 $357, as summer berthing and winter storage fees increased in 2017 versus 2016. The addition of a second heated indoor storage facility continues to be fully utilized. A trend towards larger boats as well as rate increases continue to push revenues higher. Fuel Sales were also higher in 2017, as the Marina continued to sell fuel to customers in the marketplace, despite high water levels.

Expenses were up $93 from 2016 to 2017 due primarily to Repairs and Maintenance costs, resulting from issues related to record high water levels.

Billy Bishop Toronto City Airport

In 2017, operations at the Airport continued to grow under a managed growth strategy. The two main revenue sources at the Airport are (a) Airport Operating Fees charged to Scheduled Carriers based on slot allocation and usage, and (b) AIF, which was reduced to $15.00 effective April 1, 2018. The AIF is funding the Airport's ongoing capital expenditure program, including debt service on existing Bank Loans and the Pedestrian Tunnel MSPs.

The increase in passenger volumes and Airport activity continued to drive Airport revenues in 2017 with revenue up to $48,428 versus $47,373 in 2016, an improvement of $1,055. Also included in the AIF are revenues generated from the Pedestrian Tunnel Advertising features.

On the expense side, there was an increase of $914 in 2017, with higher Wages, Salaries and Benefits, Operating Materials and Utilities, Maintenance and Repairs, Legal expenses, and Interest expenses, offset slightly by lower Public Affairs expenses.

Property and Other

Revenues were lower in 2017 by $900 compared to 2016, due to lower Property and Parking revenues. This was mainly due to loss of rental income with the sale of the 30 Bay Street/60 Harbour Street Property.

Expenses decreased by $534 in 2017 versus 2016, mainly due to lower Operating Materials and Utilities, Maintenance and Repair expenses and Realty Tax expenses.

Investments

Investment Income was up $450 in 2017 versus 2016, due to investment income earned on the proceeds from the sale of 30 Bay Street/60 Harbour Street Property.

Corporate Services

Corporate Services support TPA operations 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 2017 by $407, compared to 2016. Higher Legal expenses, Rent expenses, and Training and Membership expenses, were partially offset by the lower cost of Operating Materials and Utilities, Public Affairs expenses and Consulting expenses.

Payments-in-Lieu of Taxes to the City of Toronto (Please see Note 8 in the 2017 Audited Financial Statements)

The Port Authority was added to provincial regulations on October 30, 2017 for the purposes of Payments-in-Lieu of Taxes at Billy Bishop Airport. The Port Authority pays Airport PILTs to the City of Toronto based on a per passenger amount.

Of the eighteen Federal Port Authorities in Canada, the TPA pays one of the highest PILTs amounts as a percentage of gross revenue, ranking second on the list as per 2016 reports.

Gain/ (Loss) on Interest Rate Swap

The TPA had 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 the necessary documentation and testing/assessment in 2010 and 2011. The unamortized accumulated other comprehensive loss due to losses in derivatives previously designated as a 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. As of January 1, 2012, the ineffective portion of the gains and losses on the Swap were recognized in the Statement of Operations. The total impact of the gains and losses on derivatives including amortization in 2017 was a $146 gain versus a $130 gain in 2016. The hedge for the Swap was redesignated effective January 1, 2012 and now continues to be effective.

There are revenues and expenses related to Airport Improvement Fees included in the total revenues and expenses of the Port Authority. Note 9 on page 31 separates these out from the totals and lists separately from all of the other revenues and expenses. The AIF related revenues are collected from enplaning passengers and also include tunnel advertising revenues. AIF expenses are amortization and interest on Airport debt and also the charge on gross revenue against AIF revenue.

TPA (non-AIF) revenues and expenses are those that relate to all other operating revenues and expenses of the Port Authority, including Airport operations. Airport revenues were higher in 2017, as well as Airport expenses, due to non-routine Airport maintenance items such as Lake Ontario high water remediation efforts. Excluding the AIF, revenues and expenses results in a 2017 net loss of $1,558. With the addition of growing international business at the port, including new film production leases at PortsToronto's port property, it is expected that there will be an increase to profitability going forward.

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, 2016 of $112,119, which included an Accumulated Other Comprehensive gain of $4,613. The ending balance as at December 31, 2016 included the Net Income for the year of $6,684, plus the Unamortized Gain and Past Service Costs – IAS19R of $4,399, plus Amortization of the Accumulated Loss on Derivative Interest of $91, plus the gain on Interest Rate Swap – Effective Portion of $161, for a closing Equity balance as at December 31, 2016 of $123,454. The Amortization of $91 is included in the Loss on Interest Rate Swap in the Statement of Operations and Comprehensive Income.

The ending balance in Equity as at December 31, 2017 included Net Income for the year of $94,839, plus a Pension Gain as a result of Remeasurement of the liability - IAS19R of $1,595, plus Amortization of the Accumulated Loss on Derivative Interest of $91, plus the Gain on Interest Rate Swap – Effective Portion of $383 for a closing Equity balance as at December 31, 2017 of $220,362. The Amortization of $91 is included in the Gain 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 BBTCA. Cash and Cash Equivalents and Short-term Investments have gone up from $11,872 at the end of 2016 to $65,161 as at December 31, 2017, an increase of $53,289. Cash and Cash Equivalents that are AIF Restricted have gone down from $8,707 at the end of 2016 to $7,373 as at December 31, 2017, a decrease of $1,334. An analysis of the Statements of Cash Flows is included below.

Accounts Receivable increased from $6,497 at the end of 2016 to $9,370 at the end of 2017. The aging of Receivables are found on Page 20, Note 3 to the Audited Financial Statements. The increase of $2,873 was mainly due to the Airport Operating Fees year end adjustment for 2017.

The Port Authority holds two notes receivable with a carrying value of $24,114 (2016 - $Nil) and face value of $26,000 (2016 - $Nil) related to the sale of the 30 Bay Street/60 Harbour Street Property. The notes are non-interest bearing and payable in equal annual amounts of $8,667, due on May 1 of each of the next three years with maturity on May 1, 2020.

Comparing December 31, 2017 to December 31, 2016, Inventories were higher by $1 and Prepaid Expenses decreased by $176.

Long-term investments are $6,489 at the end of 2017.

The details on Capital Assets are found on Page 23 and 24, Note 5. Capital Assets increased by $14,559 in 2017 and on a Net Book Value basis the increase was $987, when amortization, disposals and outside funding for capital projects are taken into account.

(In thousands of dollars)

The details of the gross increase are as follows:

Port Operations	$2,566
Outer Harbour Marina	$236
Billy Bishop Toronto City Airport	$11,002
Property & Other	$755
Total	$14,559

Higher Capital Expenditures in 2017 as compared to 2016, included the BBTCA airfield rehabilitation project and the purchase of a Non-Passenger Vehicles Screening Point. Roof replacement projects resulted in higher capital expenditures in Port Operations.

Amortization allocated to operations over the years is deducted from the Capital assets, as well as amounts received for capital funding from various sources.

Accounts Payable and Accrued Liabilities have decreased by $1,776 from 2016 to 2017.

The Fair Value of the Interest Rate Swap represents the closing balance following the decrease in the loss in value in 2017 of $620.

The current portion of the Bank Loans is the principal amount to be repaid in the next fiscal year, in this case 2018.

Unearned Revenue decreased by $113 in 2017 versus 2016. 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.

Bank Loans are described on Page 29, Note 7 (a).

The Pedestrian Tunnel Concession Liability is described on Page 33 to 34, Note 14.

Employee Benefit Liabilities represents the liability recognized for Port Authority Benefit Plans and are described on Pages 25 to 28, Note 6.

Equity represents the difference between Assets and Liabilities. Equity increased in 2017 by $96,908, as detailed on the Statements of Changes in Equity on Page 4.

The financial liquidity of the Port Authority is strong, with a Current Ratio (Current Assets divided by Current Liabilities) of 6.53 as at December 31, 2017. This is higher from the Current Ratio as at December 31, 2016 of 2.04.

The financial performance ratio was slightly lower in 2017, with a Profit Margin (Net Income, excluding gain on sale of the 30 Bay/60 Harbour Street Property divided by Gross Revenue) of 10.5% in 2017 compared to 11.2% in 2016.

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 or deducts any non-cash items. These include Amortization, Employee Future Benefit Expense, Employer Contribution to Future Benefit Plans, the Unamortized Gain and Past Service Costs – IAS19R, Interest Expense offset by Bank Interest Paid, the (Gain)/Loss on the Derivative Designated as a Cash Flow Hedge and AIF Restricted Cash. An amount is then added or deducted for non-cash working capital. In 2017, this amount resulted in a decrease in cash of $4,587. This was mainly due to the increase in Accounts Receivable of $2,873, the increase in Inventories of $1, the decrease in Accounts Payable of $1,776 and the decrease in Unearned Revenue of $113, offset by the decrease in Prepaid Expenses of $176.

Investing Activities and Financing Activities are then listed. Investing Activities include Net proceeds of sale of the 30 Bay Street/60 Harbour Street Property, increases in Short-term and Long-term Investments and the Acquisition of Capital Assets listed above. Financing Activities include items related to the Pedestrian Tunnel and Bank Loans.

The end result is that the Cash and Cash Equivalents position increased in 2017 by a total of $22,851 from $6,872 to $29,723. This balance does not include Short-term Investments of $35,438 and Cash and Cash Equivalents – AIF Restricted $7,373, which decreased by $1,334 in 2017 from $8,707 in 2016. As part of the Pedestrian Tunnel Project Agreement, as at December 31, 2017, the Port Authority had a Prepaid Threshold Tunnel Deposit of $8,243. The TPA continues to invest its cash resources in infrastructure improvements that benefit all of its business operations.