SUBMISSION TO INDEPENDENT COMPETITION AND REGULATORY COMMISSION

ACTION'S BUS FARES
JULY 2006 TO JUNE 2007

MARCH 2006

Introduction:

Since the last review of ACTION fares pricing was undertaken by the Independent Competition and Regulatory Commission (the Commission) in May 2003 the ACT government has substantially progressed a number of the issues raised in that review, which are also referred to in the Commission's current Issues Paper.

A major achievement has been the development of the *Sustainable Transport Plan* (STP) which was launched in April 2004. The STP is part of *The Canberra Plan*, the overarching document that provides the overall vision and framework for action for Canberra. The main components of *The Canberra Pla*n are the *The Canberra Social Plan*, *The Economic White Paper* and *The Canberra Spatial Plan*. The STP is closely integrated with *The Canberra Spatial Plan*. The *Canberra Spatial Plan* includes some key goals, initiatives and actions that relate to transport and are directed at achieving a more sustainable transport system for Canberra. These are consistent with and mutually support the actions in the STP.

Of particular relevance to the Commission's consideration of the price direction for ACTION in 2006/07 are the STP's goals, initiatives and actions for improving public transport. A considerable amount of work was undertaken in the development of these goals, initiatives and actions, including a Transport Elasticities Study which showed that improving public transport travel times is the most important factor in encouraging use of public transport. While affordability is a consideration in people's transport decision making it is not the paramount factor. Convenience (ie frequency of services, reliability and comfort) are more influential factors. The STP sets out targets for increased use of public transport for journey to work trips, which would see usage of public transport for these journeys increase from 6.7% in 2001 to 9% in 2011.

The STP addresses one of the three major areas of concern identified in the last Commission review – the absence of an overarching strategy for public transport in the ACT.The other two major issues of concern identified were:

- ACTION's level of operating efficiency;
- the funding of ACTION's services by way of deficit financing.

In terms of each of these aspects of the business the Commission noted that progress was being made in the years preceding the 2003 Determination.

Further information on progress in these areas along with information on the other issues raised in the Commission's Issue Paper on ACTION Bus Pricing for 2006-07 (February 2006)is provided in the following sections of this submission.

3.1 Operating Costs and Efficiencies:

As the Issues Paper notes, the Commission has previously expressed an interest in ACTION's progress in achieving efficiency improvements. As the Paper also notes in 2003 the range of potential annual cost savings through efficiency improvements was considered to be somewhere between $2.6m and $9m. That range, in itself, raises some question as to what constitutes an appropriate methodology for the purpose of determining ACTION's efficient costs. Indec Consulting Pty Limited independently benchmarks ACTION against both Government and Private Operators. The last

benchmarking exercise was completed for the year 2004 whereby the conclusion was that ACTION's "cost disabilities" (operating inefficiencies) against comparable public operators was approximately $1m. This takes into account cost of Government ownership, route network size, average speeds, and other factors used to make direct comparisons of ACTION with other operators.

Indec's findings include that to the extent that ACTION's operating costs are higher than those of best practice private operators they are unavoidable due to transmission of business rules, industrial relations constraints, policy settings and the mandated use of government services. Based on Indec's findings there would appear to be minimal scope for ACTION to achieve substantial efficiency improvements unless there are significant changes to government policy In view of this, achievement of substantial further efficiencies should not be assumed for the purpose of determining future price paths.

As the Issues Paper notes, recent significant increases in fuel costs have been a major issue affecting ACTION's operating costs. To date these cost increases have been met through budget supplementation by Government. However, it should be noted that budget supplementation by Treasury for fuel price increases continues to be dealt with on a case by case basis, with no formal arrangements in place which would guarantee that supplementation will be provided in the future or what level of the supplementation will be provided. Irrespective of whether supplementation continues to be provided, in principle, it would be appropriate for users of ACTION services to also make a contribution, at the fare box, to meeting these increased costs.

While there is no empirical data available to establish that recent increases in ACTION patronage are directly related to increased fuel costs for private motorists, it seems reasonable to assume that that would be a contributing factor to patronage growth. It is understood that public transport providers in other cities (eg Sydney) have also seen recent patronage growth which is thought to be related to increased costs of private transportation. Whether or not ACTION has benefited by achieving patronage growth due to fuel price increases, it remains the case that users of ACTION services, should contribute an appropriate proportion of ACTION's operating costs at the farebox.

However, it is not considered that the totality of recent cost increases can be immediately, wholly off-set by fare increases which would return ACTION to its earlier farebox recovery ratio without causing an undesirably large spike in fares, which in turn would impact negatively on patronage. This is discussed further under 3.4 Cost Recovery (which notes that the proportion of costs recovered at the farebox in 2004/05 was 18.7% - the lowest it has been for 15 years).

Deficit Financing:

In the Price Determination 2003 the Commission made comment about deficit financing being an inevitable consequence in the absence of an appropriately structured funding model. The Commission further stated, "a funding model is essential for clearly establishing the service and the financial obligations of the Government and ACTION in providing bus network services into the future".

Work has continued within ACT Government since the last determination by the Commission on development of a funding model. Models in other jurisdictions have been examined and proposals developed for alternative funding arrangements. It has not

been possible to reach agreement on any substantive departure from the deficit funding model used to fund ACT Government agencies. Appropriate funding arrangements for ACTION continue to be considered in the context of current budget deliberations. Even though a funding model has not been formalised ACTION does measure its route costs on a physical output basis. This, combined with external benchmarking does allow for ACTION to effectively measure its costs of providing a service and the efficiency level of that service. A base percentage of fares revenue to total costs can also be established. It therefore follows that, from a base year, in this case 2003, known cost and volume increases can be extrapolated to produce an outcome in 2006 where fares increase can be substantiated based on cost and volume increases to maintain the same percentage of fares to total costs.

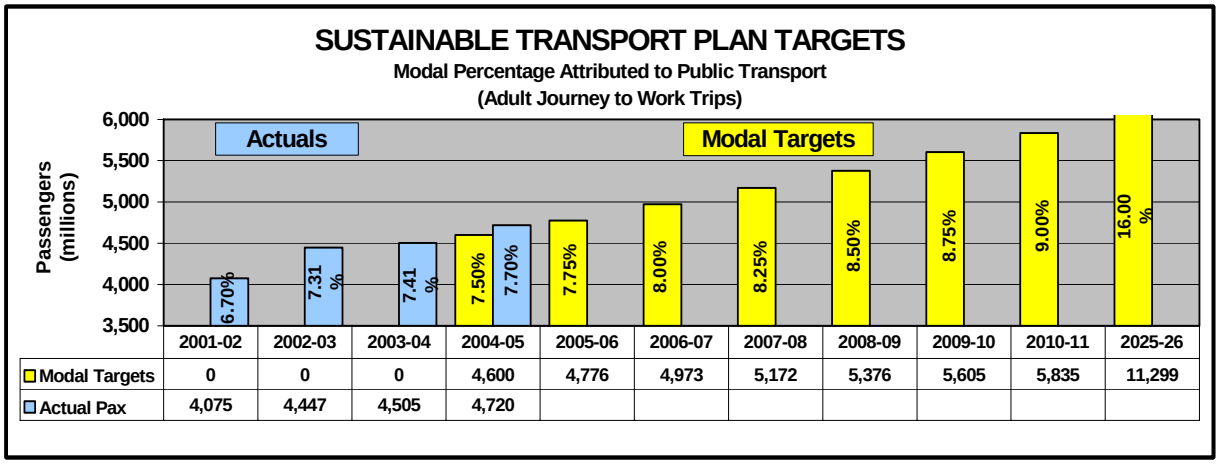
3.2 Capital costs

Just as work has continued within Government on funding arrangements for ACTION, work has also been undertaken on developing a long term bus replacement strategy. As the strategy adopted will impact on ACTION's recurrent funding requirements (in particular its maintenance costs) the fleet replacement strategy is being considered in the context of current budget deliberations. As the Issues Paper notes, the effect of the bus acquisition strategy on ACTION's operating costs will have more relevance to a longer-term price determination. However, it is evident that should the strategy continue to be based on replacement of buses at 20 years of age, this will result in a continuing requirement for additional maintenance funding. This is because retaining buses for 20 years will require funding for additional major rebuilds.

3.3 Patronage and Transport Strategy

Patronage

As noted earlier, the implementation of the ACT Government's Sustainable Transport Plan (STP) addresses the Commission's previous concern about the absence of an integrated transport strategy and sets a path for public transport covering a 25-year period. One of the targets of the STP is to increase the modal share of people travelling on ACTION buses, measured in terms of adult journey-to-work trips. The targets for the modal share for public transport have been set at 7.5% in 2004/05, 9% in 2010-11 and 16% by the year 2025-26. These targets and ACTION's current performance is included in the following chart.



As indicated in the above chart the modal share in 2001-02 represented by public transport (measured as adult journey-to-work trips) was 6.7% or 4.075 million passengers and this has since increased to 7.7% or 4.720 million passengers at the end of 2004-05.

The growth between 2001-02 and 2002-03 was mainly due to the government decision to return to a single-zone fare system, which immediately made the cost of fares more attractive to people travelling between regions. The growth between 2003-04 and 2004-05 was due to the introduction of specific express services. The *Xpresso* services, as they are named, have been designed to cut travel time and provide more direct services into the City, Russell, Parkes and Barton from outer suburbs. In addition direct services are also now operating between Belconnen and Tuggeranong Interchanges and Belconnen and Woden Interchanges, both bypassing the City. An increase in the frequency of intertown services has also contributed to the growth in adult patronage.

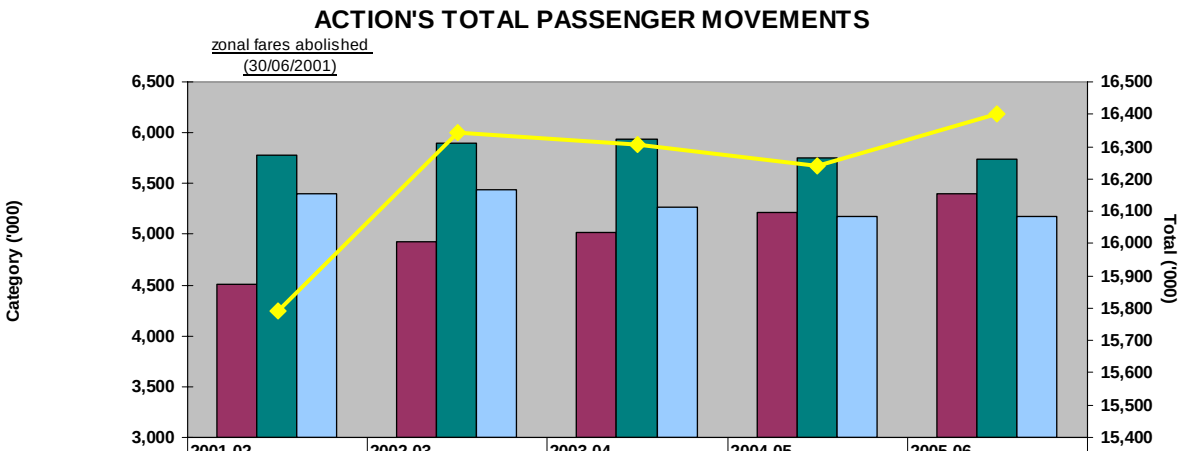
ACTION objectives for further building growth to match the modal targets are twofold involving improved infrastructure and customer information as well as enhancements to the network that further satisfies the needs of commuters. The former includes the implementation of projects such as real time information with visual displays providing customers with regular updates of services, additional bus priority lanes and intersections, dedicated busways and enhanced interchange and security facilities. These features are all aimed at providing the customer with greater information and assurance about their travel requirements.

The second part of the objective involves further network improvements such as the introduction of more express services and a review of some of ACTION's more circuitous services with the aim of providing more convenient, direct routes at higher average speeds.

Patronage Movement Between 2001-02 and 2005-06

The following chart provides information about the movement of passenger categories over recent years. The movement in adults was discussed in the section above. Patronage in regard to concessions has remained relatively stable over the years. This is a reasonable outcome in view of the significant reduction in ACTION transport concession cards issued by Centrelink between 2002-03 and 2004-05, down 26% or 3,360 cards.

School patronage has also remained stable following the short period of free travel for this category in 2001-02. The slight reduction may be partly due to students returning to pre-2001 travel modes but more likely attributed to fewer school enrolments over recent years ie, down from 60,974 in 2001 to 60,050 in 2005, a reduction of 924 students from both government and non-government schools. This potentially equates to passenger losses of about 370,000 boardings per annum



	2001-02 Actual	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Budget
Adults	4,510	4,924	5,019	5,220	5,396
Concessions	5,779	5,898	5,941	5,757	5,741
School	5,398	5,432	5,266	5,172	5,172
Total	15,789	16,344	16,305	16,241	16,400

Patronage 2005-06

Patronage in the current year is reflecting outcomes similar to patterns experienced in previous years with adults showing significant growth and concessions and schools remaining relatively stable as indicated in the table below.

Patronage Comparisons Over Years

For the Period July to January:

	(1)	(2)	(3)	(4)	(4) - (3)	
Category	**YTD 2002/03**	**YTD 2003/04**	**YTD 2004/05**	**YTD 2005/06**	**YTD VAR**	
Adult	2,822,414	2,874,641	2,945,172	3,281,980	11.4%	336,808
Concession	3,459,967	3,492,845	3,384,670	3,419,514	1.0%	34,844
School	2,747,993	2,645,968	2,516,635	2,486,713	-1.2%	-29,922
Free	52,336	48,046	50,416	51,629	2.4%	1,213
Total	**9,082,710**	**9,061,500**	**8,896,893**	**9,239,836**	**3.9%**	**342,943**

Other strategic issues

The Commission has noted that the current five-year contract between the ACTION Authority and the Department of Urban Services, for bus services expires in December 2006, and has advised that it would be helpful to have an indication as to the nature and expectations of any new contract provisions which could be expected to have financial implications for ACTION.

The nature of the relationship between ACTION and DUS will change from the beginning of the 2006/07 financial year. The Government has agreed to direct appropriation of funds to a range of statutory authorities, including ACTION, and ACTION will not, therefore, be funded through the purchase by DUS of its services under a contract arrangement. However, while there will not be a financial contract between DUS and ACTION, under the *Road Transport (Public Passenger) Services Act 2001*, ACTION will be required to enter into a service contract with the Road Transport Authority on behalf of the Territory. The terms of the service contract will reflect the service levels endorsed by Government and capable of being funded by ACTION's revenues.

Another factor which could influence ACTION's administrative, funding and service level arrangements is the Strategic and Functional Review of the ACT Public Sector and Services.

3.4 Cost Recovery

The Commission's Issues Paper made reference to ACTION's cost recovery rate through fares over recent years. The cost recovery rate in 2004-05 at 18.7% is the lowest the rate has been over the past fifteen years. This is mainly the result of cost increases, in particular whole-of-government EBA increases (up 21 per cent in the period 2002-03 to 2005-06), significant movement in the price of fuel (up 62 per cent between the start of 2002-03 to current prices in 2005-06), and maintenance costs associated with parts, up 14 per cent due to price increases but also due to the maintenance of an ageing fleet and new fleet replacement with increased levels of technology having a higher cost.

The Commissions decision to freeze fares for two years and apply CPI of just 2.5% for the third year has also partly contributed to the low recovery rate.

The 2006-07 year is now an appropriate time for some of these cost increases to now be passed on to the public transport users, particularly as other state transport providers and various industries have adjusted their prices to reflect cost increases, mainly as a result of fuel increases in recent years. However, ACTION is also mindful of keeping any fare increase at a tolerable level for the travelling public as any large adjustment may halt the current momentum of increased adult patronage.

An objective of returning to a cost recovery rate upwards of 25% or setting out to achieve a rate of 30% would best be staged to cover a period of about five years, which would smooth the extent of fare increases while minimising the potential loss in patronage.

Methodology of Approach to Fares Increases

Even though a funding model has not been formalised ACTION does measure its route costs on a physical output basis. This, combined with external benchmarking does allow for ACTION to effectively measure its costs of providing a service and the efficiency level of that service. A base percentage of fares revenue to total costs can also be established. It therefore follows that, from a base year, in this case 2003, known cost and volume increases can be extrapolated to produce an outcome in 2006 where fares increase can be substantiated based on cost increases to maintain the same level of fares to total costs.

In the attachment the cost increases on the base year 2003 are as follows:

Wage Increases – represent EBA increases per annum on all labour.
Fuel Increases – represents increases in diesel and CNG. Note that reduced unit CNG costs are reflected in the calculation reducing the overall cost of fuel. For the purposes of this exercise this is incorporated into the percentage fares to total cost calculation.
CPI – Measured on overheads excluding Fuel.
Volume increases – measured on in-service hours.

Note that the schedule refers to Route Services only. Excluded from the calculations are , SNT contract and Charter services net costs and interest earned on unspent capital funds.

4.1 Likely impacts of fare changes on patronage levels

The Issues Paper rightly observes that recent trends support the view that patronage levels are more influenced by frequency and service levels than by fare levels. On that basis, and against a background of record high fuel prices for private motorists, it is considered that there is scope for a modest fare increase, in excess of CPI, without putting patronage levels at risk. Demand elasticity for public transport fares is low and so moderate fare increases should increase net revenue to ACTION.

However, public transport fare elasticity is untested for large changes in price and it could be that large increases in fares would cause a higher than predicted decrease in patronage due to the public perception of a significant fare increase.

Recommendation

In order to maintain the same cost recovery relationship as existed in 2002-03 (23.7%), while accounting for cost increases outside ACTION's control as well as fare increases in the years up to 2005-06, a fare increase to recover an amount up to $1.893m could be justified for 2006-07. However, the preferred approach to a fare increase for 2006-07 would be an increase of around 6% which would recover approximately $1m in increased revenue. This recommendation is made to maintain current patronage momentum.

The next ICRC determination is for a three year period and ACTION will formalise a longer term fare strategy in that process.