Tourism & Transport Forum

STATE OF PLAY

AN UPDATE ON PUBLIC TRANSPORT CONTRACTING IN AUSTRALIA

NOVEMBER 2021

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Tourism & Transport Forum Australia (TTF) is the peak industry group for the Tourism, Transport and Aviation sectors. A national member-funded CEO forum, TTF advocates the public policy interests of the leading corporations and institutions in these sectors.

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS

We would like to acknowledge the many members of the transport community in Australia who have contributed to this report, including TTF members, private operators and governments.

1. EXECUTIVE SUMMARY

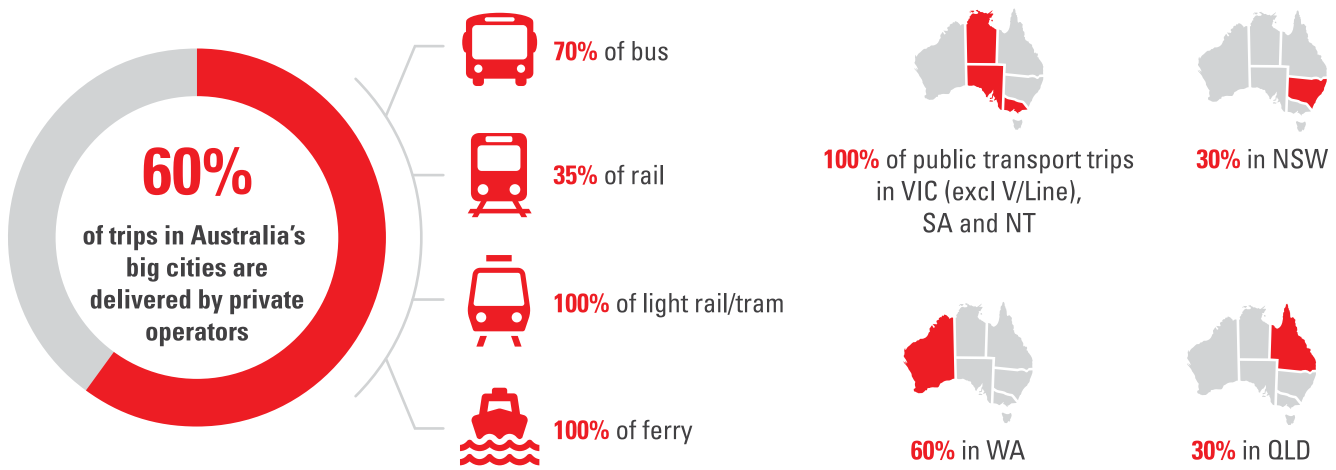
The public transport ecosystem in Australia is mature and involves numerous private sector businesses constructing, operating and maintaining services across modes including metro, heavy and light rail/tram, bus, and ferry as well as new mobility solutions. This report builds on TTF's previous contracting reviews in 2012 and 2016, and is based on extensive consultation with both operators and governments.

TRANSPORT FRANCHISING IS WIDELY USED IN AUSTRALIA AND HAS BEEN GROWING

Public transport 'franchise' contracts have existed in Australia for over 30 years, and their use continues to grow. Franchising is a well-established global model where private companies operate public transport under a contract to the government but with the government retaining ownership and control of assets, service levels and fares. In Australia, virtually all light rail and ferry services are delivered via a franchise model, as are the majority of bus services and also some heavy rail services.

Operation by the private sector has become the model of choice for virtually all new greenfield infrastructure. This includes light rail on the Gold Coast and in Sydney, Canberra and Newcastle, as well as the Sydney Metro Northwest and many remaining 'legacy' government-run operations which are gradually converting to franchises (e.g. State Transit Authority (STA)-run Sydney Buses, Adelaide rail and light rail).

Private companies operate a significant proportion of the Australian transport network



BOTH DOMESTIC AND INTERNATIONAL OPERATORS COMPETE FOR CONTRACTS IN AUSTRALIA

International operators have been attracted to the Australian market due to its relative political and financial stability, the massive investment underway in transport infrastructure, and a steady pipeline of franchising opportunities. Australia is also viewed as having managed COVID-19 shocks relatively well. International operators such as Comfort DelGro, GoAhead (with UGL), Keolis (with Downer), MTR and Transdev are all active in the Australian market, competing with local firms like Busways, Kinetic and SeaLink.

Australia is an attractive market for global and local transport providers

1. *Public Transport, Private Operators*, TTF and L.E.K. (2012), *On the Buses*, TTF and L.E.K. (2016)

CONTRACTING MODELS ARE EVOLVING

In most current franchises, revenue and patronage risk are typically retained by government, and the COVID-19 shock will likely make this universal. Private operators typically manage cost and operational risks, and often also play a role in delivering capital projects. Recently multimodal transport franchises have emerged such as the Newcastle integrated franchise (bus/light rail/ferry) and Adelaide franchise (bus/light rail). These models allow operators to play a bigger role in planning the transport system, coordinating between modes and creating a more seamless passenger experience. Contracts often offer the option for a franchise to be extended for strong performance, and with flexible key performance indicators (KPIs) that can respond to changing priorities through the life of the franchise.

FRANCHISING OFFERS CONSIDERABLE BENEFITS

The ongoing penetration of franchising is driven by the significant benefits it delivers to customers, governments, taxpayers and employees. These include improvements in service quality, greater innovation, improved operating efficiency and more diverse career opportunities for staff. While franchising a government-run operation can be politically sensitive, in Australia, governments rarely take back a contract once it has been franchised.

HOWEVER, THERE ARE MANY MORE OPERATIONS THAT COULD STILL BE FRANCHISED IN AUSTRALIA

Since TTF's prior report on franchising (*Public Transport, Private Operators, 2012*), significant operations like Newcastle bus and ferry services, several Sydney Buses contracts, and Adelaide rail and light rail have all been franchised by state governments. However, a number of scale transport operations remain in the public sector that are well suited to franchising, including:

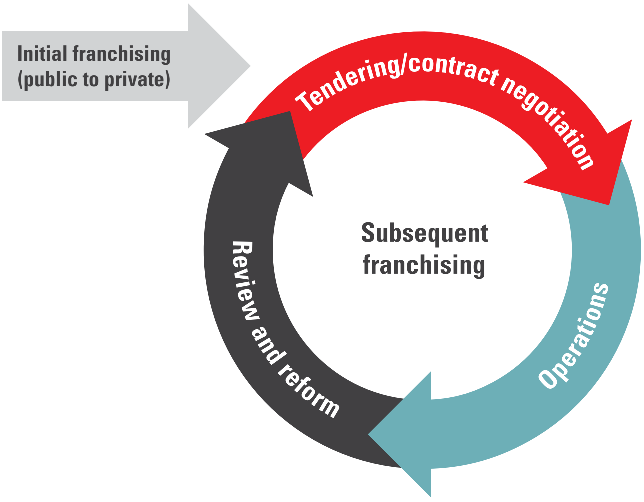
- **Bus operators:** Brisbane Transport, Transport Canberra in the ACT and MetroTas in Tasmania
- **Rail operators:** Sydney Trains, NSW TrainLink, Queensland's Citytrain and QR Travel Network, Victoria's V/Line, and Western Australia's Transperth

There is also further room to reform private bus contracts that have not yet moved to full contestability or where operators still have control over depots (e.g. some Melbourne bus contracts, South East Queensland (SEQ) private bus contracts and Outer Metro Sydney bus contracts).

THERE IS ALSO ROOM FOR IMPROVEMENTS TO THE FRANCHISING MODEL

This report has identified several potential areas for improvement, across the life cycle of the franchising model, both in the process of initial franchising and in the establishment and renewal of subsequent franchises.

Figure 1: Stages of franchising



Key improvements for action by governments across the life cycle of franchising contracts include:

- Building increased flexibility into the contracts to better allow for unexpected changes
- Better phasing of tenders across states to avoid overloading bid teams
- Better management of key franchise assets, such as depots and fleets, to support innovation and contestability, particularly for bus contracts
- Better mechanisms for sharing rewards from innovation through the franchise

Chapter 5 explores these improvements and other opportunities in more detail.

The franchising model must also evolve to address major trends and disruptions such as ongoing COVID-19 challenges, transport decarbonisation and new mobility innovations such as on-demand services, autonomous vehicles and Mobility as a Service (MaaS). This includes ride sharing (eg Uber) and other first and last kilometre ('last mile') innovation such as shared bikes and scooters (eg Beam), as well as increasing integration with car sharing (eg GoGet) and ongoing deregulation of the taxi/point-to-point transport sector.

Franchising has driven significant reform in the delivery of public transport services. Governments and transport authorities have many opportunities to fine-tune the franchising model and to extend its use to other large government-run transport operations.

2. OVERVIEW OF CONTRACTING IN AUSTRALIA

TRANSPORT FRANCHISING IS WIDELY USED IN AUSTRALIA AND HAS BEEN GROWING

There are multiple types of contracts for public transport, ranging from outsourcing to full privatisation, with franchising and public private partnerships (PPPs) in between, as outlined in Figure 2 below.[2]

Figure 2: Overview of private sector participation models

LOW — Level of private sector involvement — HIGH

	OUTSOURCING	FRANCHISING	PUBLIC PRIVATE PARTNERSHIP	FULL PRIVATISATION
DESCRIPTION	Suppliers contracted to provide an activity previously undertaken internally (e.g. cleaning).	Public sector contracts out operation of public transport service for a set period.	Design, build and operate contract.	Outright sale of a service or asset to the private sector.
ASSET OWNERSHIP	Public sector retains ownership and control of assets.	Public sector retains ownership of public assets.	Either owned by the government from construction or transfered to the Government after initial term.	Private operator owns assets.
GOVERNMENT OVERSIGHT	Contract is directly with government operator.	High level of government oversight and management of performance through contract terms.	More limited oversight (regulatory and contractual obligations).	Generally some oversight of performance and fares. Uncommon in public transport to have only regulatory obligations.
RISK ALLOCATION	Private sector bears cost risk on narrow activity only.	Many different models. Cost risk typically borne by operator; revenue risk typically lower when future revenues are more uncertain.	Private sector bears construction risk, and operating cost and performance risk. Generally does not take demand/revenue risk.	Many different models, although private sector typically takes on higher levels of revenue and cost risk for greater returns.
EXAMPLES	• Sydney Trains IT systems • Transperth rail maintenance	• Melbourne trains and trams • Perth buses	• Gold Coast Light Rail • Sydney Metro Northwest	• UK rail from mid-1990s (assets and operations separately privatised)

This paper focuses on franchising, under which a private operator typically provides all the staff and delivers the vast majority of day-to-day operations and maintenance activities. Under franchises, governments typically retain their ability to set passenger fares, determine routes and service levels, and undertake long-term planning and investment. Governments generally prefer to maintain long-term ownership (or control) of key assets (rolling stock, buses, depots, infrastructure etc.) to ensure effective competition for contracts. Franchise models in Australia typically operate on a 'gross cost' basis (where farebox revenue is retained by the transport authority and the operator is paid a fee based on the cost of operations plus a margin). This model implies the government retains all revenue risk, while the operator takes on most of the cost risk.

OUTSOURCING VERSUS FRANCHISING

In some government-run operations, specific functions may be outsourced (e.g. maintenance or cleaning). For example, in Sydney, a significant proportion of track maintenance and cleaning has been progressively outsourced, as has smartcard ticketing. For example, a UGL and Unipart Rail joint venture for rolling stock maintenance, component overhaul and supply chain services which sit alongside each JV partners' core capabilities. Whilst outsourcing can have many benefits, it is not the subject of this paper, which focuses on the franchising of holistic transport operations.

PPPs AND GREENFIELD OPERATIONS

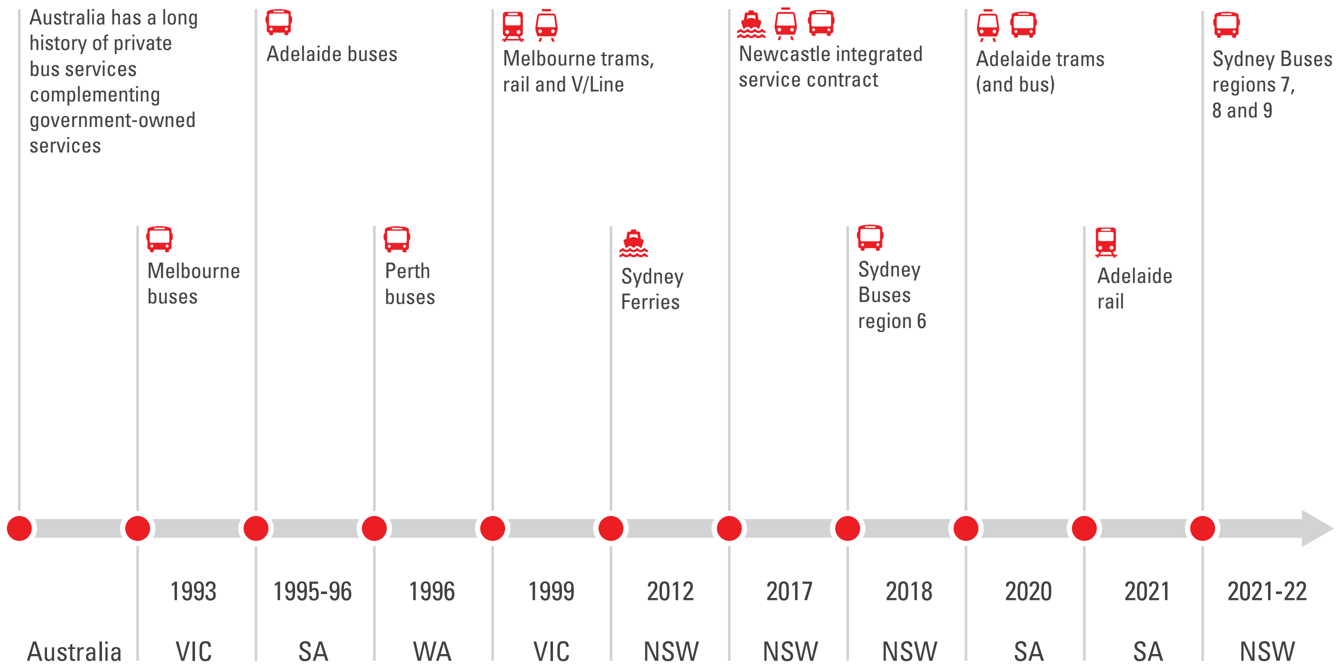
Public private partnerships (PPPs) are also growing in prevalence, in which a government authority and a private consortium form a partnership to build and deliver a public service. PPPs generally involve two phases: a construction phase and an operational and maintenance (O&M) phase, each being very different in character and requiring separate consideration when contracting. The O&M phase has many similarities to a franchise, but the structure of the relationship is significantly different due to the presence of debt and equity holders and with the operation contracted via a Special Purpose Vehicle (SPV) rather than directly to government. A key benefit of the O&M phase in a PPP is that it ensures the private consortium warrants the fitness for purpose of the design and has exposure to whole of life cost outcomes and a focus on operational/customer outcomes during design and delivery. Additionally, because debt and equity are at risk during the operational phase there is much greater potential abatement compared to a franchise. Use of PPPs in Australia is best suited to new greenfield infrastructure such as Gold Coast Light Rail or Sydney Metro Northwest.

2. *Public Transport, Private Operators*, TTF and L.E.K. (2012)

GROWTH IN FRANCHISING

There has been a significant increase in the level of franchising of public transport operations over the past three decades (as depicted in the timeline in Figure 3 below) as governments have come to recognise the significant benefits. After an initial wave of activity in the 1990s, the pace of change has accelerated again over the past five years with major new contracts in Newcastle (multimodal), Adelaide (rail/light rail) and Sydney (STA buses contract regions 6-9), in addition to all recent greenfield PPP projects.

Figure 3: Major public transport franchising events in Australia*



Note: * Operations commence
Source: L.E.K. research

Australian public transport is therefore predominantly run by the private sector, with the exception of some rail and bus networks. There remain a handful of significant and smaller opportunities for franchising in rail (NSW, QLD and WA) and bus (in QLD and SA, with NSW currently in the process of franchising the remaining STA contracts).

Figure 4 below shows the spread of transport operations across public and private sector by state.

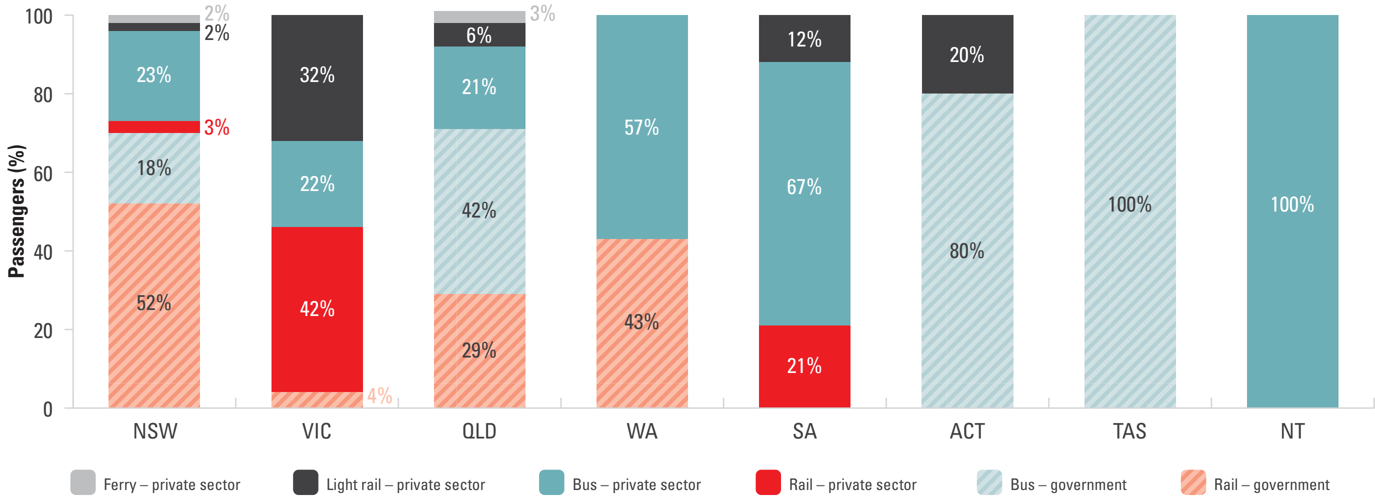
Figure 4: Australian transport operations, government vs private sector, by mode and state in 2020

Mode	Government/ private	New South Wales	Victoria	Queensland	Western Australia	South Australia[i]	Tasmania	Northern Territory	Aust Capital Territory
Rail	Government	Yes		Yes	Yes				
	Private sector	Yes[ab]	Yes			Yes			
	No service						No service	No service	No service
Bus	Government	Yes[c]		Yes[f]			Yes		Yes
	Private sector	Yes	Yes	Yes	Yes	Yes		Yes	
	No service								
Light Rail/ Tram	Government								
	Private sector	Yes[ad]	Yes	Yes[ag]		Yes			Yes[a]
	No service				No service		No service	No service	
Ferry	Government								
	Private sector	Yes[e]		Yes[h]	Yes				
	No service		No service			No service	No service	No service	No service

a. Public Private Partnerships (PPPs)
b. Currently Sydney Metro Northwest; future Metro developments include Sydney Metro City and Southwest, Metro West and Metro Western Sydney Airport
c. NSW Buses are about to be fully franchised, with the remaining STA regions 7, 8, 9 being transferred to private sector operation
d. Sydney light rail includes L1 Dulwich Hill Line, L2 Randwick Line and L3 Kingsford Line operations; Paramatta Light Rail is under construction
e. Sydney Ferries are operated by Transdev; the Manly Fast Ferry is owned by NRMA
f. Brisbane City Council operate a significant fleet of inner city buses
g. Gold Coast Light Rail is operated by Keolis Downer
h. Brisbane ferries are operated by SeaLink
i. During early 2021 all remaining South Australian transport was moved to private sector operation
Source: L.E.K. research and analysis

The growth in franchising appears to be enduring. Of all the significant operations franchised in Australia, only V/Line has reverted to public hands. Figure 5 below shows the extent of private operations by mode share across states. Figure 6 on page 9 shows the operating costs of public transport modes by state.

Figure 5 – Australian major city public transport patronage by mode and operator type



Note: NSW is in the process of franchising its remaining government-run bus services
Source: State transport authority annual reports and data; L.E.K. research and analysis

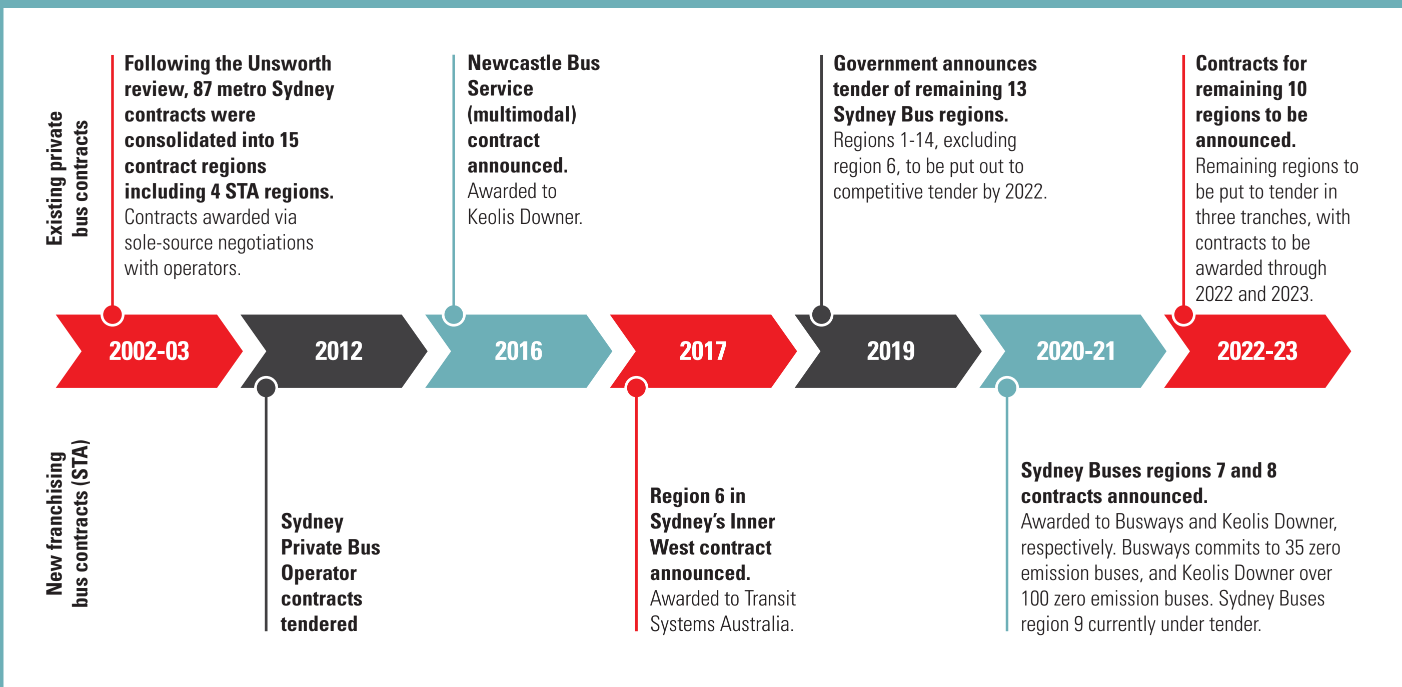
Australian franchises have dealt relatively well with the challenges of COVID-19, given low levels of revenue risk and governments typically stepping in to fund additional cleaning costs and capacity management resources such as 'sit here' stickers. Franchises with some revenue risk, for example Melbourne rail and tram operations, did experience financial pressure as farebox revenue declined. Operators have played a significant role in encouraging passengers back onto public transport after earlier COVID-19 lockdowns. There has also been a strong focus on the safety of passengers and staff.

Post-COVID-19; these operators may look to mechanisms to transfer some of this cost risk back to the relevant transport authority, especially in situations where they have no control.

CASE STUDY: BUSES IN NSW

Following several decades of experience in the design and roll-out of private sector contracts, franchising models for bus contracts have become increasingly sophisticated over time as demonstrated in TTF's 2016 report *On the Buses*. The below timeline of NSW bus franchising highlights the evolution of the model in Australia's most populous state.

Timeline of NSW bus franchising



Source: L.E.K. analysis

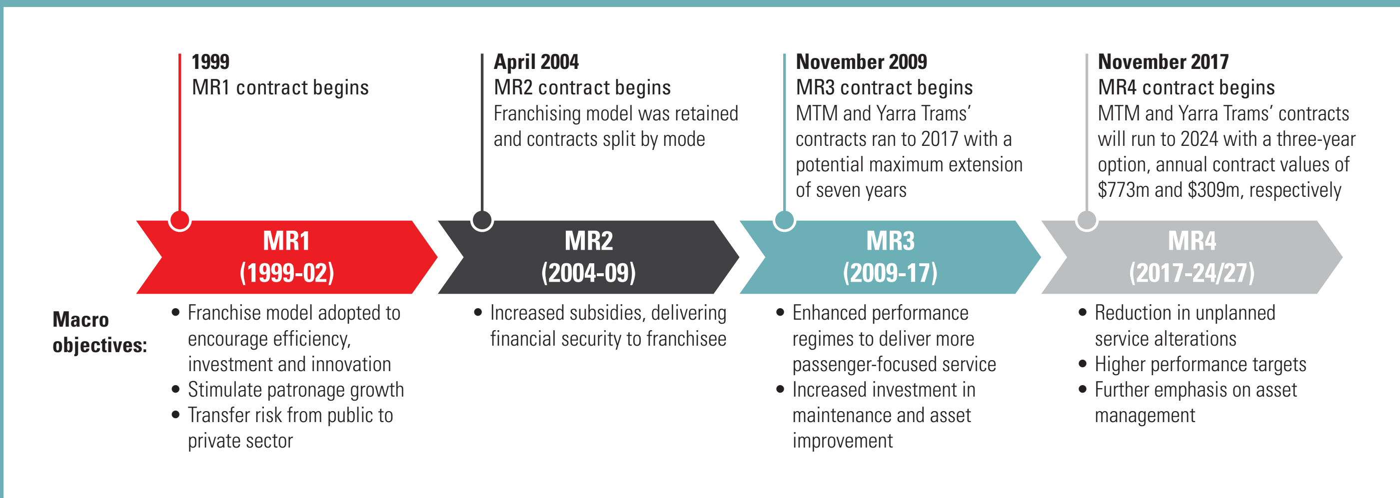
CASE STUDY: MELBOURNE RAIL AND TRAM FRANCHISES

The Melbourne rail and tram franchises have now been in place for over 20 years and have been through four rounds of franchising (MR1-MR4). There were challenges with the first contracts, related to too much revenue risk allocation to the operator(s), splitting the tram and metro rail systems, and unrealistic revenue growth and cost reduction assumptions in franchise bids. In MR2 the franchises were significantly restructured, recombining the two tram franchises into one and two rail franchises into one, altering the risk allocation and with government resuming operation of V/Line services. Subsequent franchising rounds have involved further incremental changes to risk allocation, incentives and performance measures. Both rail and tram operators changed at the commencement of MR3 and successfully extended their contracts under modified terms into MR4.

The current MR4 contracts (2017-24), operated by Metro Trains Melbourne (MTM) and Yarra Trams (Keolis Downer), are net cost contracts. These include more stringent performance and maintenance standards, featuring increased infrastructure performance such as fines for failure to improve network infrastructure standards; increased maintenance investment to minimise faults that will reduce delays and cancellations; increased failure penalties if the network experiences cancellation or delays; and penalties for poor operational performance, such as station skipping, short running of trams, poor communication and passenger information, and cleanliness.

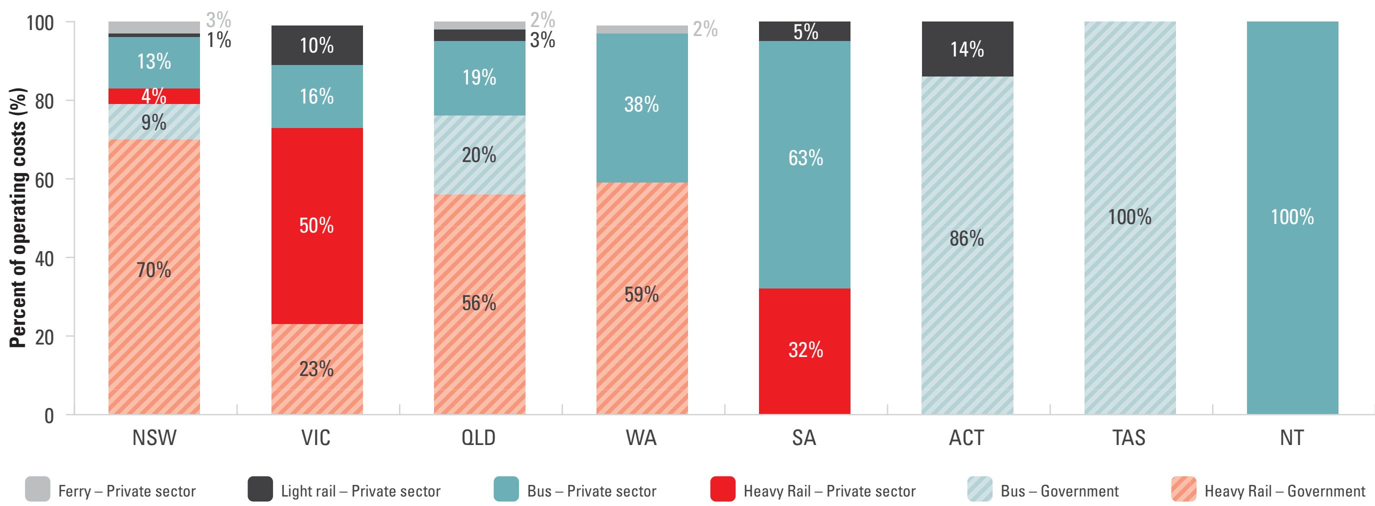
There has been significant patronage growth over the life of the franchises and a considerable lift in the quality-of-service delivery. The impact of COVID-19 has led to material losses due to falling patronage, causing losses for both the rail and tram operators that have required top-up payments from the state government.

Timeline of Melbourne train and tram franchising



Source: The Age; PTUA; PTV; VAGO; L.E.K. analysis
Source: *Good Practice Public Transport Concessions: the case of London and Melbourne*, OECD/ITF 2021; L.E.K. analysis

Figure 6: Australian major city public transport operating costs by state, mode and operator type (FY2020)



Note: Does not include depreciation expenses; NSW is in the process of franchising its remaining government-run bus services
Source: State transport authority annual reports and data; L.E.K. research and analysis

Almost all greenfield transport operations are operated under long-term franchise-like contracts (as part of a PPP model). Examples of this include:

- Gold Coast Light Rail (Stages 1, 2, 3)
- Sydney Light Rail CBD and South East and Inner West extension
- Canberra Light Rail
- Sydney Metro Northwest

Many significant new projects will also be privately operated upon completion, including:

- Paramatta Light Rail
- Sydney Metro City and Southwest
- Sydney Metro West
- Sydney Metro Western Sydney Airport link

"It was easier to make the case for the private sector on light rail because it's a new system, and the PPP structure allows it to be contestable"

– State Transport Authority

CASE STUDY: GOLD COAST LIGHT RAIL

The GoldlinQ consortium was awarded an 18-year PPP contract with responsibility for the design, construction, operations and maintenance of the Gold Coast Light Rail (GCLR). The arrangement for Stage 1 ($1.3 billion) which opened in 2014 with services operated by Keolis Downer, involved a three-year period to design and construct a new 13 km line from Gold Coast University Hospital to Broadbeach. Stage 2 ($420 million) opened in 2017 and involved construction of additional stations and procurement of trams for the section between Helensvale and Gold Coast University Hospital. Stage 3 will further extend the light rail system to the south, from Broadbeach to Burleigh Heads, including eight stations and five additional trams. Major construction is expected to commence in early 2022, with expected completion in 2025.

Procurement of Stage 3 is being delivered via variation to the existing PPP Project Deed, managed by GoldlinQ. Stage 4, a further 13 km extension from Burleigh Heads to Coolangatta via the Gold Coast Airport, is currently in the early planning stages, with funding approval for a preliminary business case.

Since 2014, the GCLR system has experienced steady patronage growth. As at 2018-19, patronage as an integrated Gold Coast passenger transport system has increased by around 50% over 2014 figures. It has also showcased the benefits of a PPP model.

Specifically:

- Benefits of a central consortium combining financing, design and construction, operations, and maintenance to wrap interface risks that would otherwise be taken by government
- Encouragement of a whole-of-life decision-making mindset
- Flexibility to spread the capital cost component throughout the operating period
- Ability to implement a strong KPI regime, with financial penalties to ensure customer-focused outcomes are prioritised
- Cost certainty to government

Operational reliability and predictability are key determinants of the success of the GCLR system. The operator has consistently exceeded the specified performance metrics monthly.

Source: Case study: Gold Coast Light Rail 2021 – Department of Transport and Main Roads; L.E.K. analysis

DIFFERENT TYPES OF FRANCHISES

Franchising contracts are typically one of three types:

1. **Management contracts** under which operational cost and revenue risks are retained by government, with the operator paid an agreed management fee, typically on a cost-plus basis whereby the operator is reimbursed for the costs incurred and is paid an agreed margin. This type of contract may or may not be accompanied by additional performance incentives. It is most often used when systems are going through a period of significant change and material risk transfer is difficult. Rail reforms announced in the UK during 2021 involve shifting from rail franchises carrying significant revenue risk to management contracts with incentives for performance.
2. **Gross cost contracts (most common in Australia)** where operational cost risks are transferred to the operator, with revenue risks retained by government. Gross cost contracts are often accompanied by incentive regimes to give operators a greater 'stake in the game' and ensure aligned authority and operator objectives. In addition to minimum service standards, this may include some revenue sharing or small patronage incentives. The vast majority of private bus contracts in Australia operate under this model, first introduced in Perth over 30 years ago.
3. **Net cost contracts** under which a much larger portion of operational cost and revenue risk is transferred to the operator (although this may be capped). This provides the operator with direct incentive to maximise franchise profitability but requires that the operator have greater control over key commercial levers (e.g. marketing, revenue protection). These are best applied in situations where there is a reasonable level of stability and predictability of future revenues.

Governments generally prefer to maintain long-term control and ownership of assets. This is particularly the case for rail but can also be true for buses and ferries. However, there are significant bus operations (typically with origins as smaller family-run businesses) in which many bus depots are still owned by operators. This has made it more difficult to achieve genuine contestability and may also complicate the forthcoming transition to electric buses, which requires investment in depots for charging infrastructure.

Franchise arrangements typically have performance regimes which are designed to incentivise the performance outcomes the transport authority is seeking, give operators a greater stake in the system and help to ensure alignment in objectives between the operator and the transport authority. Incentivised performance metrics typically address punctuality and reliability, customer experience, and asset management. Incentives and penalties are typically capped to limit the exposure of the operator and include mechanisms to adjust the metrics for events outside the control of the operator.

Franchises are typically for a single mode, although there are many examples overseas (particularly in France) and now locally in Adelaide and Newcastle where a single operator operates multiple modes. This allows the operator to play a bigger role in planning the system, coordinating the modes and creating a more seamless passenger experience. For example, in Newcastle, in addition to operating the bus, light rail and ferry services, Keolis Downer also has responsibility for marketing, signage upgrades, operating a service desk and various other network-related activities.[3]

Some services with significant tourist-related patronage, when combined with commuters, have better overall economics and may not require a government subsidy (e.g. fast airport links, some ferry services). For example, NRMA operates the popular Manly Fast Ferry service across Sydney Harbour that has achieved strong growth over the past decade and high levels of customer loyalty. Focusing on innovation and efficiency, the business operates on a fully commercial basis, including paying access fees, without a subsidy from government.

3. Newcastle Integrated Services Contract, Transport for NSW, 2016

BOTH DOMESTIC AND INTERNATIONAL OPERATORS COMPETE FOR CONTRACTS IN AUSTRALIA

Commercial public transport operators are a mix of both local and international firms, many with significant global experience. International operators have been attracted to Australia by stable government, strong population growth, significant investment in transport infrastructure and a steady stream of franchising opportunities. A number of joint ventures have emerged combining the best of international experience with local knowledge, and some Australian operators have begun to take their expertise to international markets. Australia has successfully created a significant and viable market for public transport contracts, something that has allowed franchising models in Australia to grow and evolve. Figure 7 below demonstrates the range and experience of private operators in Australia.

> ***"Our shareholders see Australia and NZ as very attractive markets with political stability, financial stability and (until recently) population growth"***
>
> **– Transport operator**

Figure 7: Overview of commercial transport operators in Australia

Region	Operator / HQ	Modes (Australia)	Countries of operations
International	Comfort DelGro (CDC), Singapore	Bus	Australia, China, Ireland, Malaysia, Singapore, UK, Vietnam
International	Keolis, France (operating as Keolis Downer in Australia)	Rail, light rail, bus, ferry	Australia, Belgium, Canada, China, Denmark, France, Germany, India, Luxembourg, Netherlands, Norway, Qatar, Senegal, Sweden, UK, USA
International	MTR, Hong Kong	Rail	Australia, China, Hong Kong, Sweden, UK
International	Transdev, France	Light rail, bus, ferry	Australia, Canada, Chile, Colombia, Czech Republic, France, Germany, Ireland, Morocco, Netherlands, New Caledonia, New Zealand, Portugal, Spain, Sweden, UK, USA
Australia	SeaLink, Adelaide	Bus, ferry	Australia, Singapore, UK
Australia	Busways, Sydney	Bus	Australia
Australia	Kinetic, Melbourne	Bus	Australia, New Zealand
Australia	NRMA, Sydney	Ferry	Australia
Australia	UGL, Sydney*	Rail, light rail, bus	Australia, New Zealand

Source: Operator websites
* frequently in joint ventures with other commercial operators; New Zealand operation a JV with ComfortDelGro from 2022

OTHER EVEN MORE RADICAL MODELS ARE ALSO EMERGING

Beyond the increasing trend of on-demand transport in franchise contracts, there are some examples of smaller towns around the world (e.g. Uber Innisfil in Ontario, Canada), that have replaced their public transport services by taking an entirely different approach to the outsourcing of services. Such models reflect possible future directions for smaller cities, enabled by different technology platforms. The growth in single-direction light motorcycle, bicycle and scooter hire is another more radical model relevant to higher-density population centres, and some of these modes are being integrated with traditional public transport.

CASE STUDY: NEW MOBILITY — INNISFIL TRANSIT, CANADA, REGIONAL TRANSPORT (UBER)

Innisfil is a small and growing town of 40,000 people north of Toronto, Canada. The local Council wanted to improve transport accessibility, and in 2016, after finding that a fixed-route bus service would be too costly for the limited level of service that they would provide, decided to explore a more affordable demand-based transit solution.

The Council partnered with Uber to connect drivers and passengers travelling in the same direction. Innisfil Transit was launched in May 2017 and is still available 24 hours a day, seven days a week.

Upon launching, passengers could pay US$3-$5 to travel to key destinations within the town, including the Recreational Centre, Innisfil Heights Employment Area and public transport hubs. Passengers could also receive a $5 discount on any other trips within Innisfil boundaries.

Two years after launch, nearly 150,000 trips had been taken through the Innisfil Transit service (which includes both the Uber general service and wheelchair accessible trips provided through another provider). Survey results from both 2017 and 2018 show that residents had a high level of satisfaction with Innisfil Transit. Specifically, in 2018, 71% of all survey respondents who had taken at least one Innisfil Transit trip were either 'Satisfied' or 'Strongly Satisfied' with the service.[4]

The Council revised the fare structure of Innisfil Transit in 2019. A $1 increase was applied to all trips as well as a monthly limit of 30 trips to help ensure that Innisfil Transit remained sustainable in the future.

Source: Uber

4. Innisfil Council 2019, *Staff Report: Innisfil Transit - Pilot Program and Support Access to Innisfil Food Bank*, Innisfil Council, pg. 2, available via: https://innisfil.civicweb.net/FileStorage/36706CEF3729468E9ECCF1C073DD3B98-Innisfil%20Transit%20%E2%80%93%20Pilot%20Program%20to%20Support%20Acc.pdf

3. BENEFITS AND CHALLENGES

FRANCHISING CAN OFFER SIGNIFICANT BENEFITS TO CUSTOMERS, GOVERNMENTS AND EMPLOYEES

These benefits were documented extensively in TTF and L.E.K.'s prior publications,[5] and are summarised in the diagram below.

Customer

- Financial incentives drive customer benefits (punctuality, reliability, patronage, customer satisfaction etc.)
- Correctly aligned incentives can spur private sector innovation

Government and taxpayers

- Financial benefits of reduced subsidy due to both faster growth in patronage and cost savings from efficiencies (incl. improved staff productivity, better asset utilisation and efficient procurement)
- Allows government to focus more on the long-term strategy for the public transport system

Employees

- Better opportunities for advancement (incl. in other jurisdictions) and increased rewards and incentives for high performance
- More straightforward for unions to negotiate with

MANY GOVERNMENTS CITE EXAMPLES OF TANGIBLE BENEFITS AT THE TIME OF FRANCHISING OR RECONTRACTING

Governments franchising or recontracting transport services in their jurisdiction often cite tangible benefits. Two examples since TTF's last report on this topic are below.

The South Australian Government at the time of franchising its rail services, said that the implementation of performance-based contracts would increase the focus on delivering significant improvements to the customer experience. It also identified potential savings of around $118 million over 12 years that would be reinvested in other important transport projects.[6]

The New South Wales Government at the time of franchising Sydney Buses region 6, said that it would include integration of on-demand transport into the contract and an increase to the number of high-frequency turn-up-and-go services. In addition, the Government said there would be 270 extra weekly services across three popular routes and savings of $140 million over eight years.[7]

> *"The fully outsourced model with a good contract allows access to the skills, capability and know-how of a private sector operator who has hands-on experience in multiple geographies"*
>
> – State Transport Authority

5. *Public Transport, Private Operations*, TTF and L.E.K. (2012), *On the Buses*, TTF and L.E.K. (2016)
6. South Australian Government media release, Forging ahead with better services for Adelaide train passengers, January 2021, www.premier.sa.gov.au/news/media-releases/news/forging-ahead-with-better-services-for-adelaide-train-passengers
7. New South Wales Government media release Transit systems boosts Inner West bus services, 13 February 2018, www.transport.nsw.gov.au/news-and-events/media-releases/transit-systems-boosts-inner-west-bus-services

CASE STUDY: ADELAIDE TRAM (TRANSIT SYSTEMS/UGL/JOHN HOLLAND)

After a competitive bid in late 2019, the Adelaide Metro tram system transitioned from government operations to a private O&M contract in July 2020. The contract was awarded to Torrens Connect (a joint venture between UGL, John Holland and Transit Systems) to run the trams in an integrated operation with the North South bus contract region. The contract also provided for the establishment of a new Operations Control Centre that met Operator and Rail Infrastructure Manager standards. Benefits sought by the state were delivery of enhanced customer experience through creating a simplified and efficient network that allowed for intermodal integration.

The contract was awarded during the commencement of the COVID-19 pandemic. Key to a successful transition was the ability to develop trust with the Rail, Tram and Bus Union, resulting in the transition of 92% of existing staff from the government to private payroll.

Recently marking one year in operation, since going live with transition of the tram service on 5 July 2020, Torrens Connect has exceeded all its KPIs in its first year of operations. It has maintained a highly collaborative relationship with the Department for Infrastructure and Transport and embedded the organisation in the community, including acknowledgements to the rightful landowners on which the business operates.

Source: Contract for the Provisions of Passenger Transport Services (North South Contract) – Torrens Connect briefing document; L.E.K. analysis

BUT THERE ARE EXAMPLES OF PROBLEMS THAT HAD TO BE RESOLVED

Not every example of franchising has been successful, and some contracts have had teething problems (e.g. initial rail/tram franchises in Melbourne from 1999, Light City buses in Adelaide from 2011). But the progressive drift towards franchising indicates that on balance, the model is delivering better outcomes than the alternative.

THERE CAN BE SIGNIFICANT CHALLENGES FOR GOVERNMENTS FRANCHISING FOR THE FIRST TIME

Political barriers: Opponents to franchising have claimed that 'privatisation' may lead to increased fares, service cuts, and reduced service quality (which typically would be outside the control of the operator, prohibited by the contracts or against the incentives provided to the operator) and profiteering by the operator.

Complexity: When franchising for the first time, there are many important decisions to be made, including defining the industry structure (e.g. number of contracts, asset ownership, access arrangements etc.), packaging the operations, designing the contract and developing a performance regime.

Industrial relations: Trade union opposition can lead to industrial relations concerns which may deter policymakers from pursuing franchising and its associated benefits. These challenges can be exacerbated by a low appetite for change amongst the workforce, who may be concerned about job security.

While these barriers are material, they have been consistently overcome by many different governments persuaded by the demonstrable benefits of franchising. However, it does require careful preparation, adequate resourcing, a clear narrative that focuses on customer benefits and strong political leadership.

SECOND AND SUBSEQUENT ROUNDS OF FRANCHISING CAN ALSO BRING CHALLENGES FOR GOVERNMENTS AND OPERATORS

Achieving effective contestability can sometimes be difficult. There can be a real or perceived incumbency advantage for existing operators, particularly if they own or control key assets as part of the franchise (e.g. bus depots), reducing competition.

Franchise bidders for an existing franchise may face information asymmetry with an incumbent operator that possesses a greater understanding of the local market and contract. However, an incumbent's familiarity with the operation may result in a more pessimistic bid compared to bids from less well-informed new entrants.

Transaction costs (of several million dollars) can appear to be significant, but these are relatively modest when set against the overall size of operational payments over a seven- to 10-year contract (hundreds of millions of dollars).

Franchise bids (particularly those with significant risk transfer) have been known to suffer from excessive optimism in terms of future passenger growth or cost savings, resulting in unrealistic bids. This can ultimately lead to the failure of the franchise, or the contracting government being required to step in and provide additional funding.

Lastly, there have been examples of incomplete bids, where an operator misjudges or miscalculates the resources required to meet the requirements of the tendered contract. This risk can be mitigated by rigorous bid evaluation to identify whether a bidder has offered an unrealistically low price. The steady progress towards more franchising and very few examples of reversal demonstrate that on balance, the model is considered to deliver more benefits overall than the alternative. While franchising does require careful design and implementation to be successful, Australia now has over 30 years of experience to leverage in setting up franchise structures for success.

The next chapter considers some of the best practices of franchising in Australia.

4. BEST PRACTICES

FRANCHISING MODELS IN AUSTRALIA DEMONSTRATE MANY STRENGTHS

Franchising in Australia has matured over the recent three decades into a model with many positive features across the states. Key elements highlighted as strengths include:

Low revenue risk: This has provided reasonable stability to franchises, particularly during unforeseen events like the COVID-19 pandemic. Going forward, it will likely be more expensive for governments to ask operators to take on significant revenue risk. For net contracts in particular, full transfer of risks is likely to be something operators will be more cautious about in the future.

Government capability to assess bids: As the market has matured, the ability of teams to assess bids has also improved, reducing the risk of an under-costed tenderer winning. Perth bus franchising has been highlighted as a market that has benefited from longevity and consistency in both processes and personnel.

Transparency of risk allocation and pricing: Typically, Australian states carefully consider the risks to be transferred. Tender processes and agreements need to be transparent so that the state can understand what price they are paying for each risk the operator takes on. The Perth bus contracts were identified as providing high levels of clarity about risk transfer.

Increasingly interactive processes: Governments seek to involve a wide range of bidders in their tender processes to ensure contestability and are also increasing the amount of interactivity during bids. This allows potential ideas and innovations to be tested and refined as part of the tender process. For example, the on-demand transport pilots initiated by Transport for NSW involved a highly interactive bid process.

Balanced allocation of cost risk: The general approach of governments in Australia is to use indexation regimes for general inflation and specific costs like fuel. There is also a strong focus on only allocating risks to operators when they can manage them, to avoid these risks merely being priced into bids.

A tailored approach to contract length and extensions: Contract length ranges from five to 10 years, with an average of around seven years. This gives operators sufficient time to understand the business, implement a range of initiatives and see the benefits realised, before having to embark on the next tender. Short-term extensions of one to two years help to give governments more flexibility in the timing of tenders. Lastly, KPI-based contract extensions (like MR4 in Melbourne) can give operators first rights to the next contract, subject to satisfactory performance.

> *"Interaction with the bidders before the EOI was helpful, and we managed to make the full process interactive, even with COVID-19"*
>
> – State Transport Authority

Bespoke approach for particular situations: Governments have shown an increasing willingness to embrace different contract models (e.g. multimodal contracts) and incorporate new innovations (e.g. on demand), helping to make Australia an attractive market for global operators.

Multimodal contracts: Such contracts which are more widely developed overseas but have now been shown to work successfully in Australia (e.g. Newcastle). With the right incentives in place, multimodal contracts offer the potential to increase efficiencies in operations management, improve flexibility in times of disruption, including related to events management. They also drive a greater focus on customer outcomes across the whole transport ecosystem.

CASE STUDY: SYDNEY FERRIES

Transdev Sydney Ferries (formerly Harbour City Ferries) operates the Sydney ferry network on behalf of the NSW Government, with other operators running some private services. The origins of this Sydney Ferries franchising dates back to October 2008 when the NSW Government announced a market testing process for the operations of the Sydney Ferries fleet in response to the report of the Special Commission of Inquiry into Sydney Ferries, carried out by Bret Walker SC.

Various components of the Sydney Ferries network have since been franchised including Manly Fast Ferry services (2010), Lane Cove River services, as well as the wider Sydney Ferry network which has been through two rounds of franchising in 2012 and 2019.

For the wider Sydney Ferries network, the first franchising for network operations and maintenance in 2012 resulted in responsibility for the service moving from the Government to the private sector for the first time since the 1950s, via the Harbour City Ferries 50/50 joint venture then of Transfield Services and Transdev Australasia (Transdev subsequently bought out Transfield's (then Broadspectrum) shareholding). Franchising can and does generate benefits for the State and its citizens. A report by the Audit Office of NSW into the Franchising of Sydney Ferries Network concluded that franchising did deliver significant savings, good service performance, and effective risk transfer from government to the private sector operator.

In 2019, Transdev was awarded a contract to continue operating the Sydney Ferries network contract for a term of nine years. Franchising often provides a vehicle for service improvement, innovation deployment, increased safety, and community benefits. Innovation will be central to the new contract delivering a range of benefits to improve the customer experience, including more frequent services, new vessels, and a trial of new On Demand Ferry service in the Bays Precinct. Franchising has to date generated customer satisfaction improvements, with feedback increasing from 94% to 99% since 2012.

Source: Transdev Sydney Ferries timeline 2021 – Transdev; TTF Transport Position Paper: Revitalising Sydney Ferries 2009 and Audit Office of NSW: Franchising of Sydney Ferries Network services: Transport for NSW; 2016 L.E.K. analysis

Timeline of Sydney Ferries franchising

2008

NSW Government called for private sector bids to provide ferry services under contract. Later decided to keep Sydney Ferries as a government-owned and -operated entity.

Sydney JetCats high speed service discontinued. The route was deregulated and both Manly Fast Ferries and Bass & Flinders Cruises began operating services.

2010

Sydney Fast Ferries (SFF) awarded five-year contract. Manly Fast Ferries continued to operate services between Circular Quay and Manly as per its commercial contract.

2012

Transfield and Transdev enter a 50/50 joint venture to operate Sydney Ferries under a seven-year franchise contract.

2015

Government puts out a tender for a combined fast ferry service to commence in 2015. Manly Fast Ferries wins a commercial contract to exclusively operate the service for seven years, removing SFF.

2016

Transdev exercises option to purchase Broadspectrum's share of the Harbour City Ferries contract.

2017

The Manly Fast Ferry service is purchased by NRMA. Contract is set to expire in 2022.

2019

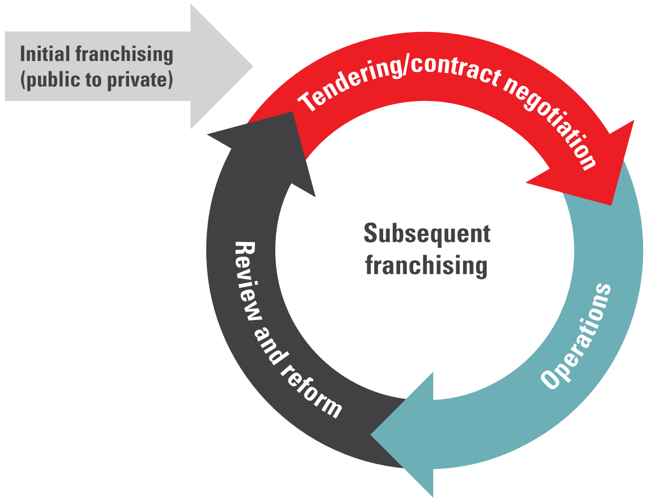
Transdev awarded a new nine-year franchise contract to operate Sydney Ferries services.

Source: L.E.K. analysis

5. OPPORTUNITIES FOR THE FUTURE

THIS REPORT IDENTIFIES SOME IMPROVEMENTS TO THE MODEL AS WELL AS BROADER OPPORTUNITIES

Improvements have been identified in the tendering/contract negotiation phase (generally relevant for both first and subsequent franchises) and the operating phase.



IMPROVEMENTS CAN BE MADE IN THE TENDERING AND CONTRACT NEGOTIATION PHASES

Clear and consistent allocation of risk to operator only when they can control it: This requires being as clear as possible in the tender process what risks are being taken on by the operator. Operators commented that it is becoming increasingly involved and expensive to submit a bid, so being very clear on the outcomes sought by the government helps focus their efforts. Governments should continue with the principle that risk should sit with the party best able to manage it. Where risk is passed on to the operator that they cannot mitigate, they will price it into their bid.

Building increased flexibility into the contract: There is generally a need for greater flexibility in contracts to account for uncertainty across the life of the contract, in particular major projects (e.g. major capital projects, the electrification of buses, other changes in priorities or the impacts of disruptions such as COVID-19).

Increasing government control of or access to critical assets: Governments have sensibly attempted to dilute private sector control of assets critical to the overall network over time, although there is still more to do. To maximise contestability, ideally there should be full government ownership (or control via access agreements) of key franchise assets such as depots.

Better phasing of tenders: Peaks and troughs in tender activity, both within and between states, can have negative consequences. Having multiple overlapping bids reduces competition as bid teams which cover the whole country cannot cover all the opportunities. Long gaps between tender processes and personnel changes can cause a loss of 'corporate memory' and relevant skills in government teams.

Clearer role allocation: Greater transparency and clarity is required in tender processes regarding the respective roles of the transport authority versus the operator. If it is the case that the operator is to run the network while the state focuses on customer and policy/strategy, this needs to be explicit and consistent. Reducing information asymmetry can also reduce the quantum of risk that operators may price in.

Carefully tailoring the tender approach if a significant network change is proposed: When a tender process involves a significant change to the network, the process needs to provide a baseline for comparison, give bidders an appropriate time frame in which to respond and ensure there is a consistent evaluation framework for tenders. The last round of Adelaide bus franchise tenders asked bidders to provide both baseline service plans and options for service reform.

Learning from other jurisdictions: With multiple jurisdictions franchising public transport, there are many examples in Australia of how to deal with significant problems in the world of franchising. Better communication of best practices between state transport authorities could help to continually improve the quality of future franchise arrangements such as those held by TTF, the International Association of Public Transport (UITP) and via the International Conference Series on Competition and Ownership in Land Passenger Transport (Thredbo Series). However, given the growing importance of effective franchising, there may be a role for a more permanent best practice forum or even a think tank or dedicated policy body focused solely on passenger transport contracting.

> *"The contract we took over had good on time running, but the bus speeds were slow, which gave customers a poor experience"*
>
> **– Transport operator**

Continuing to evolve customer-focused performance metrics: With limited revenue risk, but also much more technology for measurement, there is a need to continue to evolve customer performance metrics to ensure operators focus on customers. Specifically, there is a concern that too much focus on 'on-time running' can create a perverse incentive to slow down timetables, to the detriment of customers. The Perth franchise regime closely monitors bus running times using GPS data and periodically resets the timetables to ensure unnecessary delays are minimised. A further example of possible innovation would be KPIs that measure the quality of the door to door customer journey, expanding beyond mode by mode performance.

Enabling innovations by less prescriptive tenders: By being too prescriptive in their base offering, authorities sometimes provide little scope for innovation, which over the life of the contract may stifle improvement and potentially lead to worse customer outcomes and poor operating conditions.

Improving contestability of contracts through dilution of private sector control over key assets: There are several sizeable operations in Australia which, while privately operated, are not effectively contestable, with depot ownership a major factor. These include significant bus contracts in parts of Melbourne, South East Queensland and outer metropolitan Sydney. This limits the benefits which would be derived from competition, including value for money for taxpayers.

Careful management of workforce and industrial relations implications: It is important to invest time in taking careful account of workforce and industrial relations implications when transferring from public operations to private or from one franchise operator to another. In the recent Adelaide rail franchising, the workers were given three options for their future employment in the conversion from public to private operation, and some chose not to transfer to the new operator.

OTHER IMPROVEMENTS HAVE BEEN IDENTIFIED IN THE OPERATIONAL PHASE

Involving operators more extensively: There is an opportunity for greater involvement of operators in areas traditionally held by the authorities in Australia. Examples would include network planning, system integration, revenue protection, marketing and customer information, which are all key drivers of customer satisfaction. In Australian contracts, these functions are mostly owned exclusively by authorities. While this helps to ensure there is consistency across multiple operators/modes, the model can inhibit operators from quickly responding to customer or operational requirements as changes/improvements can be slowed down through bureaucracy.

> *"The innovations delivered on the NRMA-owned Manly Fast Ferry, and its subsequent popularity, serve as a powerful example of the benefits of greater market-led innovation"*
>
> **– Industry commentator**

Giving operators more say in management of the customer relationship: Across Australia, government authorities typically take primary ownership of the customer relationship, with the aim of ensuring consistency between modes and operators. However, this can also act as a brake on innovation and speed of development and has limited the focus on customer experience by some operators. There is greater logic for giving operators more responsibility for customers where there is revenue risk transfer or multimodal contracts. The innovations delivered on the NRMA-owned Manly Fast Ferry and its subsequent popularity serve as a powerful example of the benefits of greater market-led innovation. During interviews for this paper, operators and authorities expressed more differences of opinion on this topic than almost any other area of the franchising model.

Develop better sharing of rewards from innovation: In Australia, the operator typically does not carry revenue risk, and customer focus is encouraged by KPI-linked incentives and, of course, operators' desires to be well positioned for future tenders. Better potential rewards for operators may help to further boost innovation. For example, during COVID-19, reduced patronage meant that services ran early and required longer dwell time at stations/terminals to meet their contract targets, leading to a worse experience for customers overall. Global contracts offer greater opportunity to pursue commercial ventures using the fleet, network infrastructure (such as operating retail concessions) or services, customer data, or even construction developments along or above rail corridors. Providing additional means for value capture encourages more innovation, and with revenue shared between operators and authorities, this can also lead to new opportunities to raise funds for infrastructure or service upgrades.

LOOKING FORWARD, FRANCHISES WILL NEED TO ADAPT TO NEW REALITIES

Fleet decarbonisation: In 2020, transport was the third largest source of emissions across Australia (88Mt of CO_2), which had been growing steadily until 2019.[8] This shift to zero emissions buses is already underway. The NSW Government has committed to transition its 8000 bus fleet to zero emissions vehicles by 2030. The most recent NSW bus contract (STA region 8) awarded to Keolis Downer includes 125 new electric buses over 8 years.[8] The Victorian Government has pledged all new public buses to be zero emissions from 2025 and the recently announced 2022-2031 Metropolitan Bus Franchise, awarded to Kinetic, provides for the phasing in of new zero and low emission buses. Bus depots will require significant electrical charging infrastructure which, if operator owned, will pose challenges for future contestability of franchises.

For rail, decarbonisation requires transition to green electricity sources or (for diesel powered fleets) moving to hydrogen fuel. Whilst decarbonisation may present significant challenges to the current model, it could also act as a catalyst for rethinking asset finance and fleet/depot ownership. On the water, the NRMA is preparing to operate Sydney Harbour's first electric passenger ferry services.

New mobility: Australian franchises will also need to facilitate the future of transport, including innovations like MaaS, and increasing preferences for on-demand transport and other first/last kilometre connections like electric bikes and scooters (such as the Beam scooters pictured) and integrated car sharing. As the proliferation of new technologies grows the onus will be on operators and transport authorities alike to integrate and deliver seamless multimodal customer experiences. The most successful operators will be those that are open to driving innovation throughout their network. Enabling MaaS will require different performance metrics, increased multimodal integration and new payment methods/charging structures.

Some new mobility technologies such as connected and autonomous vehicles and advanced air mobility may seem on the distant horizon. However, earlier forms of autonomous vehicle technology (such as SAE Level 3-4 autonomy) will be available in the current term of some contracts.

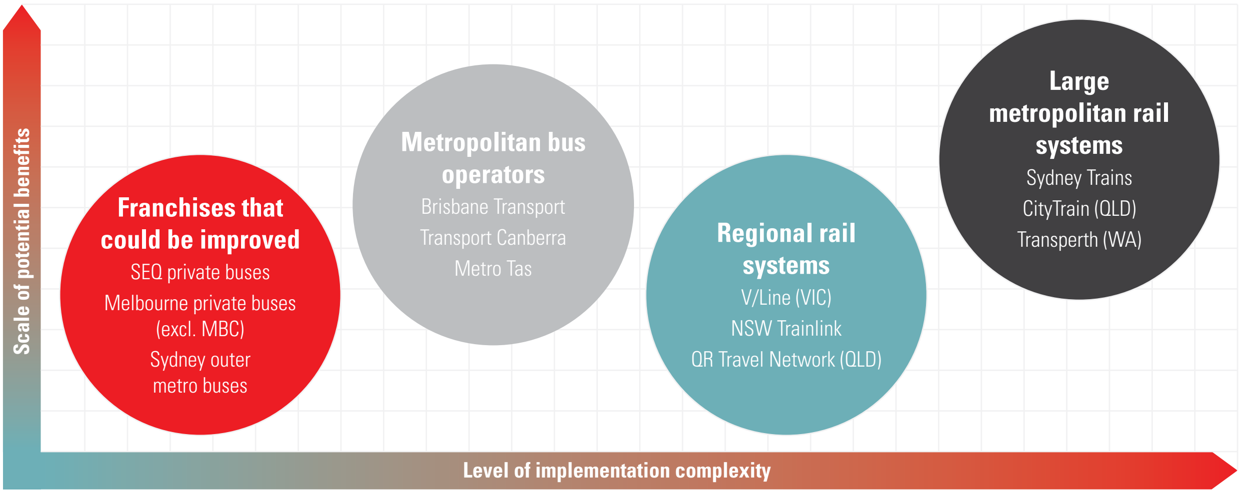
Operators should keep a watching brief on new mobility developments, including multimodal transport spanning bus or rail and last kilometre passenger services like Uber and work with transport authorities to enhance services where applicable, or at a minimum facilitate a seamless integration. The growth in drone-based delivery services like Wing, which is already commercially operating in Australia, should also be factored in to planning.

8. Australian Government, Department and Industry, Science, Energy and Resources, National Greenhouse Gas Inventory Quarterly Update: December 2020, https://www.industry.gov.au/data-and-publications/national-greenhouse-gas-inventory-quarterly-update-december-2020#annual-emissions-data
9. New South Wales Government, Transport for NSW, media release

EVEN MORE AUSTRALIAN TRANSPORT OPERATIONS COULD BE FRANCHISED

There remain a number of large and small operators that are well suited to franchising, which could deliver benefits to customers, governments and employees. Figure 9 below highlights opportunities for more existing services to be franchised.

Figure 9: Opportunities for future franchising in Australia



These include large rail operators (Sydney, Brisbane, Perth), regional rail operators (NSW, QLD, VIC), remaining government-run metropolitan bus operators (Brisbane, Canberra, Hobart), and bus systems already privately operated that could adopt more progressive franchising models (South East Queensland, some Melbourne contracts and outer metropolitan Sydney).

IN SUMMARY, FRANCHISING IS WORKING WELL, BUT IT NEEDS TO CONTINUE TO EVOLVE AND COULD COVER MORE OPERATIONS

Over the past three decades, Australia has made great progress in reforming the delivery of public transport. It has established itself as one of the most attractive global markets for private sector operators, driving strong competition, bringing new innovations and delivering value for money for governments and taxpayers. While the current franchising regimes are generally working well, there is a range of incremental refinements that would deliver even greater benefits, and there are remaining government-run operations well suited to the model that could still be franchised.

6. APPROACH AND METHODOLOGY

A number of leading organisations involved in the planning, contracting and delivery of public transport were interviewed as part of this work. This has been supported by research and analysis of public transport statistics.

We are grateful for the contributions and input of the following organisations:

PRIVATE SECTOR

- Busways
- Keolis Downer (incl. Yarra Trams)
- NRMA
- SeaLink/Transit Systems
- Torrens Connect
- Transdev
- UGL

GOVERNMENT

- Department for Infrastructure and Transport, South Australia
- Department of Transport, Victoria
- Department of Transport and Main Roads, Queensland
- Transport for New South Wales
- Transperth, Western Australia.

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