

ON THE BUSES

THE BENEFITS OF PRIVATE SECTOR INVOLVEMENT
IN THE DELIVERY OF BUS SERVICES

February 2016



In partnership with



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EXECUTIVE SUMMARY

BUS SERVICES PLAY A CRITICAL ROLE IN PUBLIC TRANSPORT PROVISION IN AUSTRALIA

Buses provide extensive public transport coverage in Australia's capital cities, including regular timetabled services and school buses. In metropolitan areas buses provide approximately 40 per cent of overall public transport trips amounting to nearly 600 million journeys per annum, or roughly 1.5 million trips each day. Buses are the most significant public transport mode in all major cities other than Sydney and Melbourne.

This critical role for buses will continue as our cities evolve. The population, spatial size and economies of our cities will grow over coming decades and the importance of service industries will continue to expand. Bus services will continue to serve as both direct mass transit links to our major CBDs and will become increasingly important in connecting commuters to transport hubs. At a local level, many local government councils are supporting the provision of smaller community bus services, often operated by community transport organisations.

Across the major capital cities, bus services cost approximately \$2.8 billion each year to operate, with around 20-25 per cent of this cost paid by passengers, and the remaining 75-80 per cent paid by governments. Getting the best value for money from these services is therefore an important area of transport policy.

THE PRIVATE SECTOR PROVIDES MANY BUS SERVICES TODAY

The private sector already plays a significant role in the delivery of bus services. Private operators run all bus services in Melbourne, Perth, Adelaide and Darwin. While Sydney Buses and Brisbane Transport (both government-owned operators) carry the majority of bus passengers in these cities, there are significant private bus operations in the middle suburbs and outer metropolitan areas. Canberra and Hobart both have exclusively government-run bus services.

The private operators are a mixture of small, family run businesses, larger Australian companies (for example, Ventura, Transit Systems), and international groups (for example, Transdev, Keolis Downer, ComfortDelGro). All private operators hold contracts with state governments.

BENEFITS OF PRIVATE SECTOR BUS OPERATIONS

There is strong evidence from Australia and internationally that the private sector can deliver bus services more cost effectively than government operators. Around the world unit costs savings on transition from public to private operations have ranged from 20 per cent to as high as 55 per cent.¹

Typical areas of greater efficiency include improved staff productivity, greater labour flexibility, better asset utilisation, more efficient procurement and leaner head office structures. To retain these benefits and ensure bus contracts offer value for money, it is important that contracts are retendered on a regular basis (at least once every six to eight years) and that the retendering process ensures effective contestability.

In terms of innovation and service delivery, the private sector tends to have greater incentive to innovate and exceed performance benchmarks than government-owned operators, due to the risk of losing their contracts as well as continuous monitoring of performance against clear criteria.



Image courtesy of Transit Systems

1. L.E.K. / TTF, *Public Transport, Private Operators* (2012), p. 28.

BEST PRACTICE CONTRACTING MODELS EXIST

The contracting model for governments to purchase bus services from the private sector is well established, but continues to evolve. Under this model, governments maintain full control over fares, service levels and usually retain ownership of assets. The most critical element of the contracting regime is effective contestability: ensuring that there is open and fair competition for contracts every six to eight years, and that there is sufficient interest from the private sector to ensure competitive tension in the process. Enabling access to bus depots within the contract area is a particularly important factor in effective contestability. This report describes ways to facilitate access to bus depots by a new entrant, as well as other best practice elements of contracting (Section 4). Contracting arrangements in most Australian cities are moving progressively towards these best practices, but progress is slow as incumbent operators actively defend their legacy ownerships of depots, buses and asserted “grandfather rights” to routes. Significant determination (and political conviction) is required to successfully implement reform.

There are two substantial opportunities for meaningful reform

1. State and territory governments should franchise government-run bus services in Sydney, Brisbane, Canberra, Hobart, and Newcastle. If savings of 20 per cent were to be achieved over time from contracting these entities, it could generate more than \$1 billion collectively over five years that could be spent on additional services, new buses or other areas of public transport.
2. Existing private bus contracting regimes in Melbourne, Brisbane and Sydney should move further towards best practice contracting. In particular, securing effective access to bus depots for a new entrant is a critical element of achieving effective contestability. Other improvements could include: better real-time monitoring of bus services (to inform service design and contract management), allowing sufficient time for assembling bids, continuous improvement of KPI regimes, and providing reasonable patronage incentives.

The benefits of these reforms will be

- lower overall costs to governments, giving them the ability to invest in more services, new equipment, and provide better overall service delivery to customers
- better customer service and innovation

More effective and efficient bus services, as part of an overall public transport system, will lead to more liveable and competitive Australian cities.

1. OVERVIEW OF METROPOLITAN BUS OPERATIONS IN AUSTRALIA



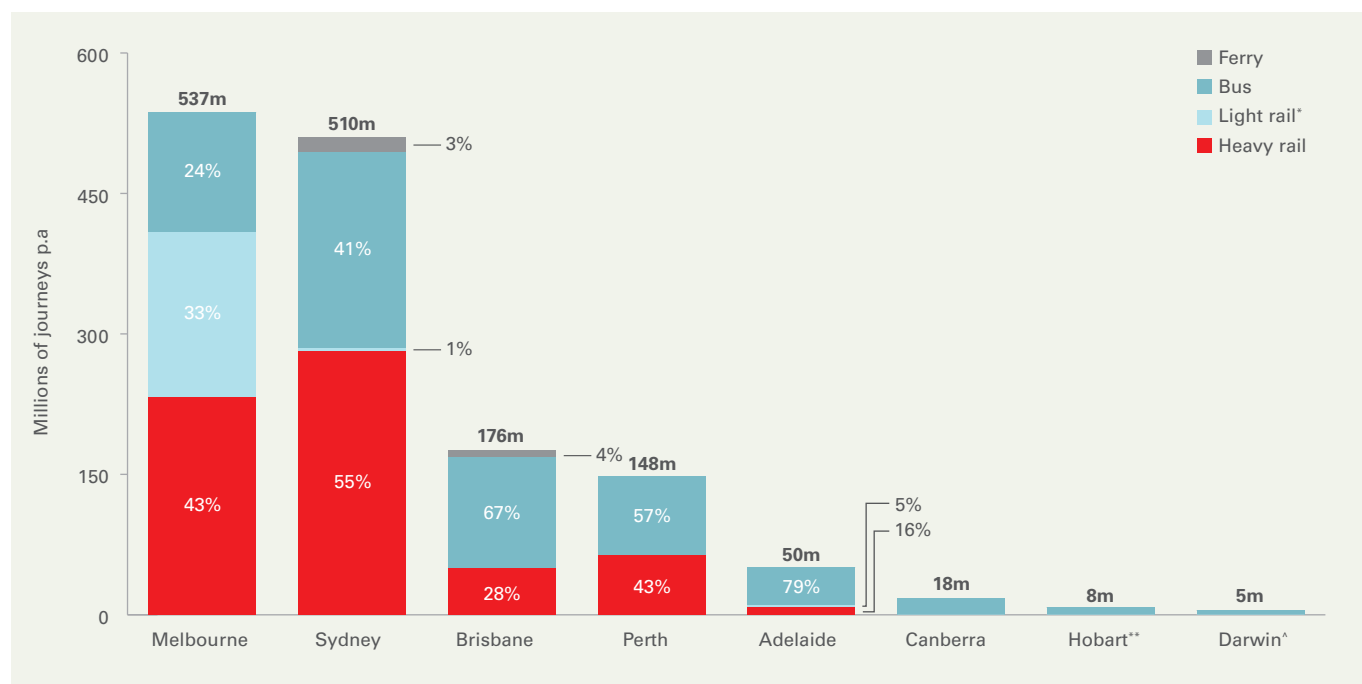
1. OVERVIEW OF METROPOLITAN BUS OPERATIONS IN AUSTRALIA

BUS SERVICES ARE A CRITICAL PART OF PUBLIC TRANSPORT PROVISION IN AUSTRALIA

Buses play a critical role across metropolitan, regional and rural areas by providing connectivity that is vital to a well-functioning transport network. In metropolitan areas, buses provide mass transit into urban centres, they provide feeder services to the broader public transport network (rail, light rail and ferry) and they link outer suburban centres through orbital bus routes. In regional and rural areas where passenger densities do not justify higher-cost and less-flexible options such as heavy rail and light rail, they are the main backbone of the public transport system. In all areas, buses play an essential role in getting students to and from school.

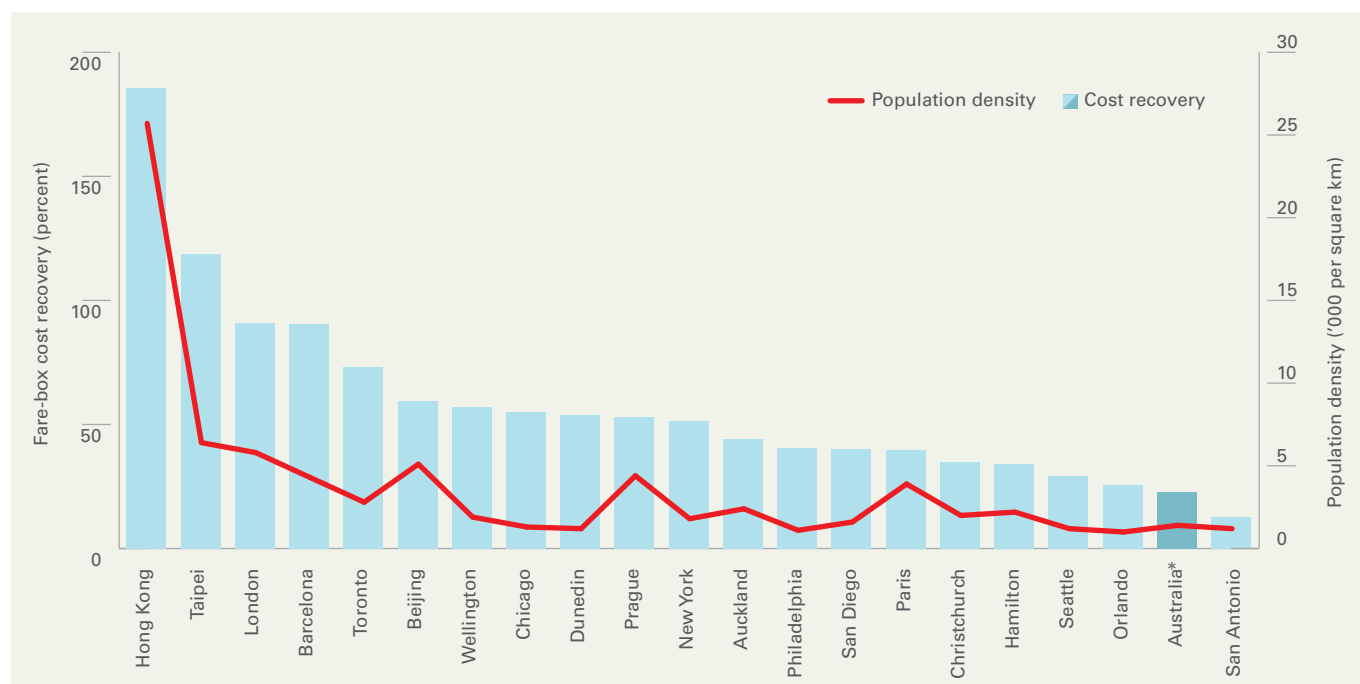
Buses account for around 40 per cent of all public transport journeys, representing over 600 million trips per year. The mode share of buses varies significantly by capital city, ranging from 24 per cent in Melbourne to almost 80 per cent in Adelaide. This is a reflection of the role that buses play in each of these cities. For example, in Melbourne, buses have the lowest mode share and service predominantly outer suburban areas, with much of the inner city serviced by the tram and rail network. However in Sydney, buses carry almost as many passengers as rail. In Adelaide, Perth and Brisbane, rail networks are less extensive and buses play a more significant role. In Canberra, Hobart and Darwin, buses are the only form of public transport available.

Figure 1: Public transport patronage by city – FY2014



* Refers to Melbourne's tram services. ** Reported by Metro as statewide services but consistent with BITRE figures for Hobart only. ^ Darwin figures based on 2014 service kms converted using 2013 passengers to service kms ratio. Source: State and Territory Department and Business Annual Reports. L.E.K. Analysis.

Figure 2: Estimated international public transport cost recovery rates (2012-13)



Source: City transport body annual reports; Demographia World Urban Areas 2014. L.E.K research and analysis.
 Note: * Australia represents an average of Sydney, Melbourne, Brisbane and Perth

Across the major capital cities, bus services cost approximately \$2.8 billion each year to operate. Approximately 20-25 per cent of this cost is paid by bus passengers through farebox revenue, and the remaining 75-80 per cent is paid by the government (and ultimately by taxpayers). This level of cost recovery is similar to other modes,² but low relative to international public transport benchmarks (see Figure 2).

This paper is focused on bus services in metropolitan areas, which carry the greatest volume of passengers and incur the majority of costs. This encompasses a fleet of approximately 9,000 buses, delivering seven billion service kilometres and carrying 600 million passengers per annum.

THE PRIVATE SECTOR DELIVERS MORE THAN HALF OF ALL BUS SERVICES TODAY

Across Australia, the private sector already plays a significant role in the delivery of bus services. Private operators run all bus services in Melbourne, Perth, Adelaide and Darwin.

In Sydney (Sydney Buses) and Brisbane (Brisbane Transport), government-owned operators carry the majority of bus passengers, particularly in inner city areas. However there are significant private bus operations operating in the middle suburbs and outer metro areas of both cities. Canberra and Hobart both have exclusively government-run bus services.

The private operators are a mixture of small, family run businesses, often with many decades of services in a local area, larger local companies with multiple contracts (for example, Ventura and Transit Systems), and large international groups (for example, Transdev, Keolis Downer and ComfortDelGro). All private operators hold contracts with state governments. In Adelaide and Perth these contracts were put in place via contracting out formerly government run services, and have been re-tendered several times. Sydney has recently completed two rounds of tendering with private operators. Other contracts have been in place for many years, and while most are contestable in theory, in practice there is limited effective competition for reasons discussed further below.

² See, for example, Audit Office of NSW, *NSW Auditor-General's Report Volume Seven 2014 Focusing on Transport*, p. 18.

Historically, private bus operators in cities such as Melbourne and Sydney have tended to be either small, family run businesses or larger local businesses running multiple contract areas. Some of these companies have serviced the same territory for several decades. Over the past decade, some jurisdictions such as Sydney, Adelaide and Melbourne have introduced more contestable processes which has resulted in at least one national player emerging (Transit

Systems) and greater participation of international players in the Australian market (for example, Transdev, Keolis Downer and ComfortDelGro). Today there are over 40 private operators involved in the delivery of metro bus services across more than 80 contract areas. The largest public and private operators in the sector are shown by state in the table below.

Table 1: Providers of bus services in Australian capital cities

LOCATION	GOVERNMENT	PRIVATE (NOT EXHAUSTIVE)
Sydney (~15 contract regions)	Sydney Buses (State Transit Authority)	<ul style="list-style-type: none"> • Busways Blacktown • Forest Coach Lines • Ingleburn Bus Services • Transit (NSW) Liverpool (Transit Systems) • Hillsbus Co (ComfortDelGro Cabcharge) • Neville's Bus Service • Punchbowl Bus Company • Transdev
Melbourne (~28 contracts)	Not applicable	<ul style="list-style-type: none"> • Dysons • Eastrans • SITA • Transdev • Ventura • Westrans (ComfortDelGro Cabcharge)
Brisbane (~16 contracts)	Brisbane Transport (Brisbane City Council)	<ul style="list-style-type: none"> • Bribie Island Coaches • Brisbane Bus Lines • Bus Queensland • BusLink • Caboolture Bus Lines • Hornibrook Bus Lines (Keolis Downer) • Kangaroo Bus Lines • Logan City Bus Service • Mt. Gravatt Bus Service • South West Transit • Thompson Bus Services • Transdev Queensland • Translink Australia Group (Sunbus, Surfside)
Perth (~10 contract areas)	Not applicable	<ul style="list-style-type: none"> • Swan Transit (Transit Systems) • Transdev WA • Path Transit (Keolis Downer)
Adelaide (~9 contract areas)	Not applicable	<ul style="list-style-type: none"> • SouthLink (Keolis Downer) • Torrens Transit (Transit Systems) • Light City Buses (Broadspectrum formerly Transfield Services)
Canberra	ACTION	n/a
Hobart	Metro	n/a
Darwin	Not applicable	<ul style="list-style-type: none"> • Territory Transit (Transit Systems) • BusLink

2. CONTRACTING MODELS



2. CONTRACTING MODELS

TYPES OF PUBLIC TRANSPORT CONTRACTS

There are a number of different ways in which the private sector can be involved in the operation of public transport services. Broadly speaking, these include outsourcing, franchising (also referred to as “contracting out”), privatisation and public private partnerships (PPPs). These four models can be thought of as points along a continuum of participation, differing in the scope of the contracts, who owns the assets and the level of risk the private company takes on (for further information, please refer to the 2012 L.E.K. /TTF publication *Public Transport, Private Operators*).



Figure 3: Overview of private sector participation models

	<div> <div>LOW</div> <div>LEVEL OF PRIVATE SECTOR INVOLVEMENT</div> <div>HIGH</div> </div>			
	OUTSOURCING	FRANCHISING	FULL PRIVATISATION	PUBLIC PRIVATE PARTNERSHIP
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	Outright sale of a service or asset to the private sector	Design, build and operate contract
ASSET OWNERSHIP	Public sector retains ownership and control of assets	Public sector retains ownership of public assets	Private operator owns assets	Typically transfers to government after initial term
GOVERNMENT OVERSIGHT	Contract is directly with government operator	High level of government oversight and management of performance through contract terms	Generally some oversight of performance and fares. Uncommon in public transport to have only regulatory obligations	Generally limited oversight (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	Many different models, although private sector typically takes on higher levels of revenue and cost risk for greater returns	Private sector bears construction risk, and operating cost and performance risk. May or may not take revenue risk
EXAMPLES	<ul style="list-style-type: none"> • Railcorp IT systems • Transperth rail maintenance 	<ul style="list-style-type: none"> • Melbourne trains and trams • Perth buses 	<ul style="list-style-type: none"> • UK rail system (assets and operations separately privatised) 	<ul style="list-style-type: none"> • Gold Coast Light Rail • Sydney Metro Northwest

Franchising is the most common form of contracting, particularly for bus services that do not involve the infrastructure complexity of rail systems. Under a franchising model, governments typically contract out the operation and maintenance of a public transport service for a set period but retain ownership of the assets (or if owned by the private sector, government has the right to take ownership). Governments also generally retain significant control over fare levels and service levels (for example, setting minimum requirements for timetables, routes and service standards). Within franchising, a range of contract models exist with different approaches to allocating risk between the government and the private operator (for example, management, gross cost and net cost contracts) and with

different structures for asset ownership. These are described in more detail in Section 4.

HISTORY OF BUS CONTRACTING IN MAJOR AUSTRALIAN CITIES

Public bus services in each Australian city have evolved in quite different ways, depending on the extent of historical private sector involvement, and policy choices by governments over several decades.

Contracts can broadly be divided into three categories, as shown in the table below.

Table 2: Contracting categories

SERVICE RESPONSIBILITY	EXAMPLES
Transitioned from government to private	Perth (all) Adelaide (all) Melbourne (~30% of routes) Darwin (all)
Always government operated	Sydney Buses (State Transit Authority) Brisbane Transport (Brisbane City Council) ACTION (Canberra) Metro (Hobart)
Always operated by private sector	Sydney (11/15 regions) Melbourne (~28 contracts, 70 per cent of routes) Brisbane (~16 contracts)

A concise history of the bus contracting regime in each capital city is provided below.

PERTH

Perth had a large government-run bus network until the 1990's. Following an extensive review, the Perth bus system was franchised to the private sector in two phases in 1996 and 1998 (see case study on the following page for further detail).



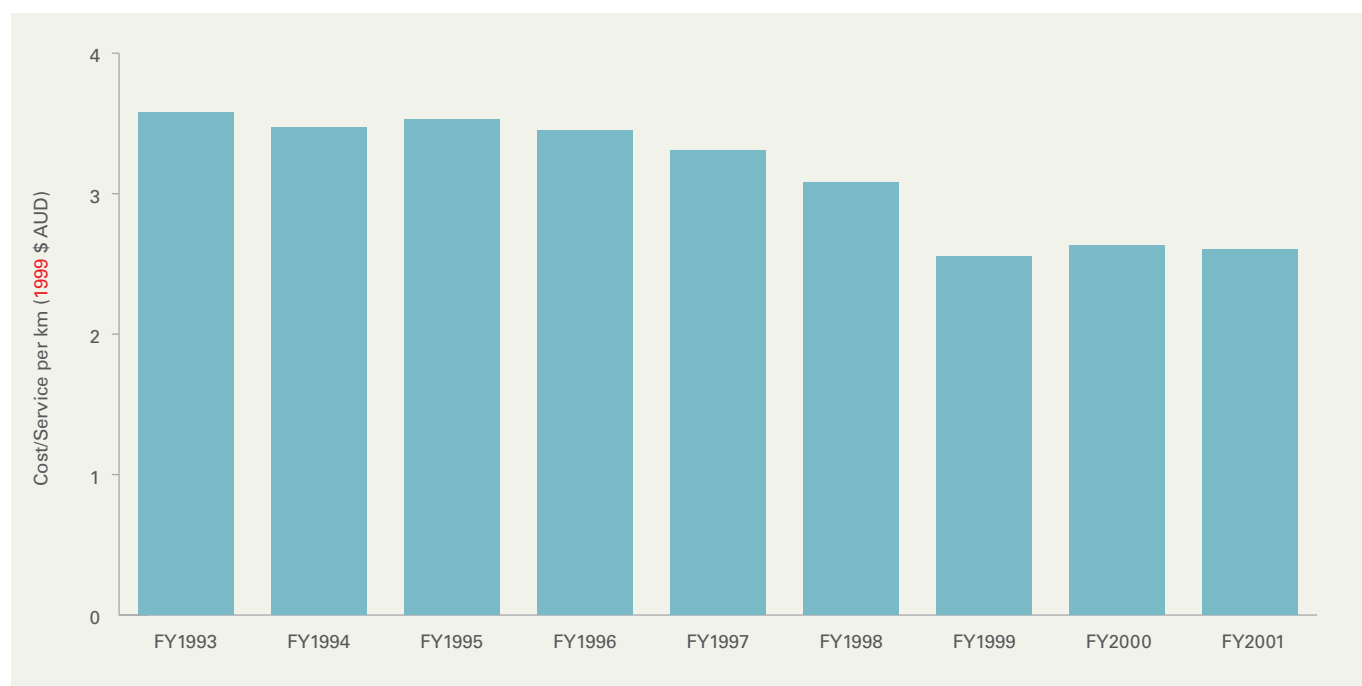
Image courtesy of Transit Systems



CASE STUDY TRANSPERTH (PERTH): FRANCHISING THE BUS SYSTEM

Following a 1993 review that identified major inefficiencies in the monopoly public bus authority, the Perth bus system was put out to competitive tender in two stages. Approximately half of the system was franchised in 1996, and the remainder in 1998.³

Figure 4: Decline in government subsidy per service km following privatisation of Perth buses (FY1993-01)



Note: Figures for FY2000 and FY2001 are estimated. Source: Bus reform: further down the road; a follow on examination into competition reform of Transperth bus services, Auditor General of Western Australia. 2000

3 Bus Reform: Further down the road, Auditor General (WA) 2000

The aim of the reforms was to reverse long-term trends of increasing costs and decreasing patronage. The franchising model adopted saw the ownership of buses and infrastructure remain with the state (along with route, fare and service controls), while private companies were responsible for the operation of services.

This franchising program delivered substantial cost reductions while total service kilometres increased. One of the key gains was an improvement in staff productivity. The level of government subsidy per service kilometre reduced by 29 per cent, from \$3.58/km in 1992-93 to \$2.55/km by 1998-99 (Figure 4) demonstrating the significant saving franchising was able to achieve. This equated to savings of more than \$30m per annum or more than 20% of the historical cost of bus services.

Strong patronage growth and continued operational efficiencies over the last ten years have been driven in large part by a range of initiatives led by the private sector.

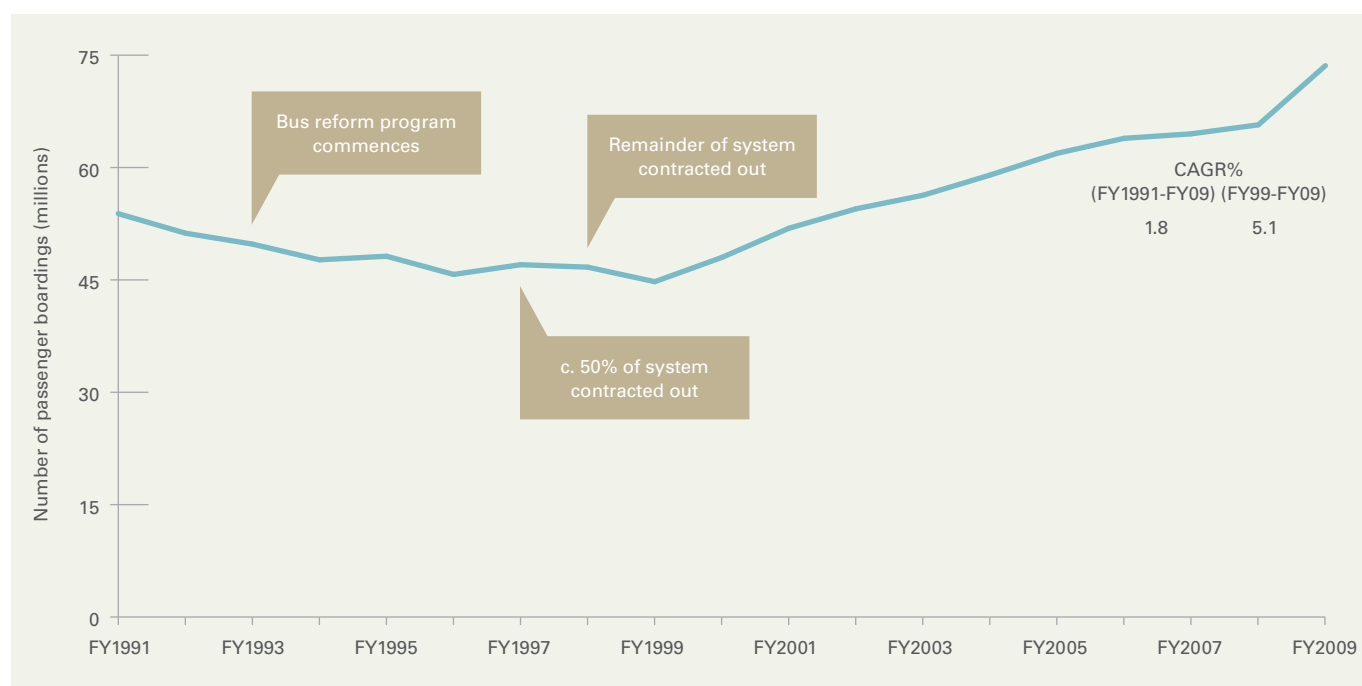
These include:

- **Innovations in route planning and optimising frequency:** This involved cutting some routes, introducing new routes and changing frequencies. This has resulted in improved asset utilisation and closer alignment of services to customer needs.
- **New depot management strategy:** This involved the strategic placement of smaller depots closer to areas of operation. This has reduced dead running time and has also resulted in a more empowered and dynamic culture within each depot.

Competition between operators has given the industry a renewed focus on high customer service levels. Customer satisfaction levels have been consistently higher under franchising than government operation.

The Transperth model has remained largely unchanged in the last 15 years and is widely regarded as a success in franchising.

Figure 5: Perth bus patronage (FY1991-09)



Source: WA Public Transport Authority Transperth Annual Report 2008/09



B LANE
24hrs

40
AREA

BUS LANE

LANE

ADELAIDE

In line with Perth's experience, Adelaide was able to demonstrate significant benefits from contracting-out operation of its bus services in terms of a reduction in subsidy per passenger. Adelaide has re-tendered periodically, always choosing to remain with private sector provision of services.

The Adelaide system was initially franchised between 1994 and 1996, with two contracts awarded to private operators and the remaining contracts negotiated with the government operator.

Following a review and modification of the contracting system in 1998, the system was rationalised into seven contracts that were all competitively tendered to four private operators (including the original contracts awarded through the initial franchising). In 2004, one of the operators withdrew from providing services at the midpoint of its contract.

A further tendering round occurred in 2010 for contracts to commence in mid-2011. This resulted in a change of operator for one of the three groups of contracts. These contracts are for eight years (to 2019) with the possibility of further extensions of four years.

MELBOURNE

In Melbourne all bus services are run by the private sector. The government did operate a number of routes through the Public Transport Corporation (PTC) during the 1980's, but these were franchised in two tranches in 1993 and 1998, respectively, and have subsequently been subject to competitive re-tendering. These routes incorporate approximately 30 per cent of the operating bus network. These contracts were won by Transdev in 2013 and are predominantly in the east of the city, but also include three orbital routes (901, 902, and 903). The remainder of the network (approximately 70 per cent) is privately operated (but government subsidised) under contracts with the government, but have not ever been contested due to disagreement between operators and the government over its authority to tender these contracts. These services are spread across more than 16 separate operators, and the contracts are due to expire in 2018.

DARWIN

The remaining 40% of Darwin's bus services were franchised to the private sector in 2014 with Transit Systems (through Territory Transit) chosen in July 2014 after a tender process. Prior to this contract, these services were government run and branded as Darwinbus.

The NT Department of Transport stated that the contract provided a saving of almost 13 per cent per kilometre for taxpayers while maintaining service levels with the same routes and fares.⁴

Territory Transit commenced service in October 2014.

SYDNEY

Sydney's bus contracts have been subject to considerable reform over the last 10 years. Major reforms were triggered by the Unsworth review (concluding in 2004), involving:

- Consolidation of contract areas from >80 to 15, with the right size and scale for efficient operations (see Figure 6);
- A series of strategic corridors with fast, high-frequency services across regions to meet new passenger demand;
- Introduction of contestability for contracts after a negotiated transition period agreed with industry;
- Enabling legislation to give powers to the state to access fixed and moving assets to ensure continuity of service at renewal stage; and
- A change of the contracting model from net cost to gross cost plus incentives for patronage growth and service quality.

Leveraging the gains made from earlier reforms, Sydney's 11 bus contracts were re-tendered during 2012 and 2013, and the contract terms were further refined. In addition, four new contracts were awarded to Ingleburn Bus Services (Interline), Hillsbus Co. Pty Ltd, Punchbowl Bus Company Pty Ltd, and Neville's Bus Services (Busabout), respectively. While there was only one new entrant (Transit Systems) the government still achieved significant savings of \$45 million per annum over 10 years. Both the government and the private sector believe that the new contracts are delivering greater benefits in terms of improved customer service, enhanced on-time running, and additional buses.⁵

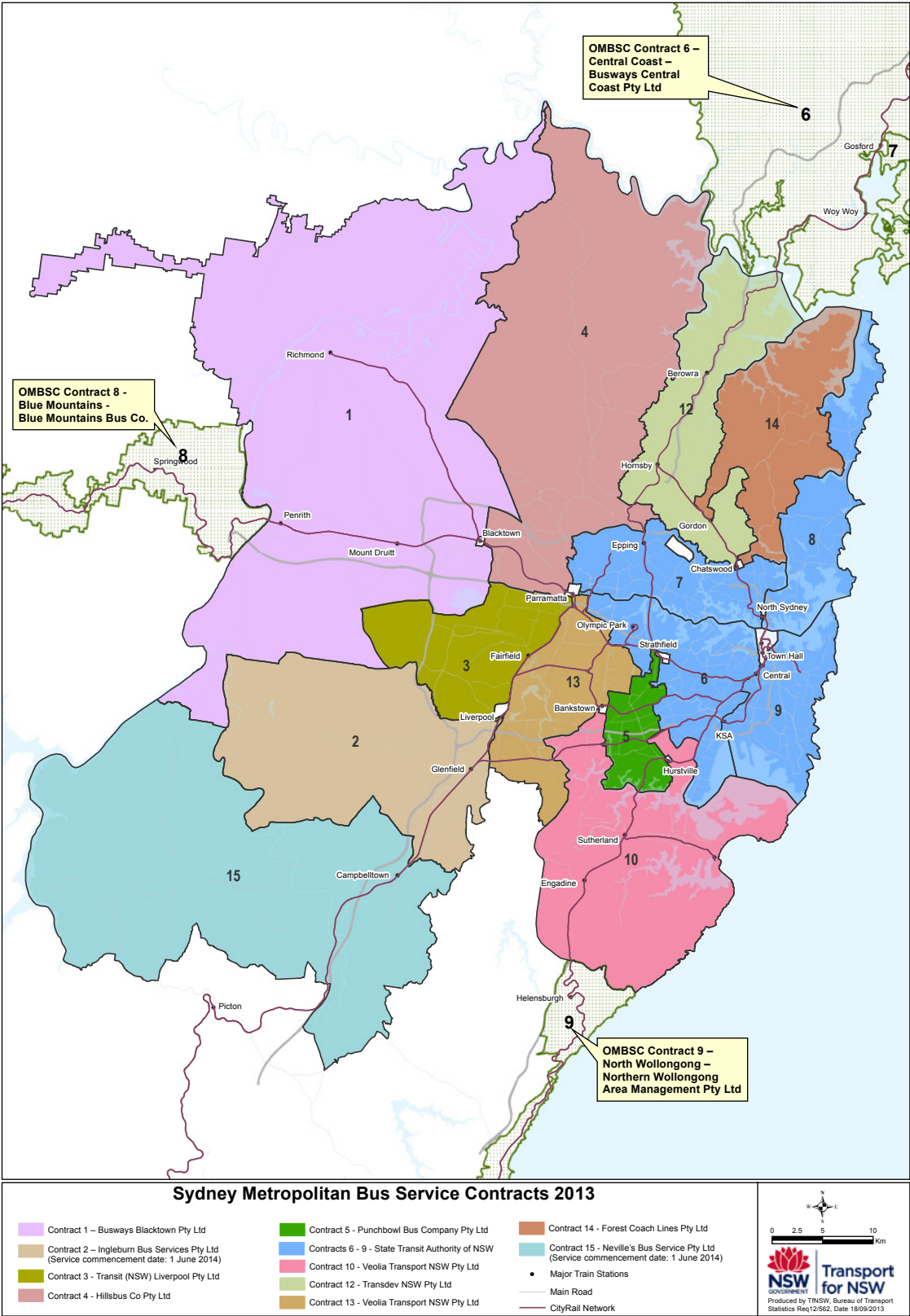
Sydney Buses (State Transit), the government-owned operator, remains by far the largest service provider. While its four contract areas have been structured to allow franchising at some point, this has yet to take place.

In early November 2015, the NSW Government announced that it will be looking to the private sector to plan, deliver and operate Newcastle buses, ferries and the new light rail line in an integrated network franchise. Transport for Newcastle has been set up to be the entity responsible for the management of the integrated network. A market sounding process is currently underway.

4 Northern Territory Government Department of Transport, *New Providers for Darwin Bus Service*, 6 July 2014.

5 Minister for Transport (NSW), *Media release: More than 60 new buses and improves customer service with new bus contracts*, 28 August 2013.

Figure 6: Transport for NSW bus contract map, 2013



Source: Transport for NSW

BRISBANE AND SOUTHEAST QUEENSLAND

In Brisbane, the Brisbane City Council owns and operates Brisbane Transport, the largest bus operator which largely serves the inner city areas. Subsidy is provided by both the city council as well as the state government via the Department of Transport and Main Road's Translink Division. While the services are delivered under contract, they are not tendered.

The remainder of services in South East Queensland are provided by the private sector under contract. There are 16 operators with exclusive rights in their contract areas. Current Queensland government policy is for these contracts not to be subject to an open tender process.

CANBERRA

In Canberra, public transport services are provided by the ACT Internal Omnibus Network (ACTION). From July 1 2016, the ACT Government's new transport agency, Transport Canberra, will coordinate ACTION as well as Canberra's future light rail network.

A review of ACTION by the ACT Auditor-General in 2010 found that ACT government subsidies had steadily increased from \$60 million in 2005-06 to \$77 million in 2010-11, and that there was significant scope for ACTION to improve operational performance and cost effectiveness.⁶

HOBART

In Hobart, urban public transport services are operated by Metro Tasmania (Metro), which is a government-owned business that was formed in 1998 by corporatising the existing Metropolitan Transport Trust.

Metro operates bus services in Hobart, Launceston and Burnie under a service contract with the Department of State Growth. In addition to these services, Metro operates a number of urban fringe services under separate contracts.

There are also some private operators that operate services outside urban areas.



⁶ ACT Auditor General, *Delivery of ACTION Bus Services*, 2010, pp. 3-5.

3. BENEFITS



3. BENEFITS

Experience in Australia and internationally has shown that when carefully designed and managed, franchising (or “contracting out”) public transport services can lead to significant benefits.⁷ While these benefits are not always dependent on contracting, it can be a valuable catalyst for bringing a clearer focus on performance using strong commercial incentives. The three main beneficiaries from franchising are:

- **Customers:** Improving the customer experience through private sector innovation and investment, use of contractual incentives to increase focus on customer satisfaction, and a stronger customer focused workforce culture.
- **Governments and taxpayers:** Reducing public subsidies enabling reinvestment in services as well as other non-financial benefits to government such as clarification of transport priorities and greater certainty over future transport budgets.
- **Employees:** Increasing employee job satisfaction and career development through opportunities available in the private sector.

Governments still play a central role in setting the desired outcomes from franchising through the incentives incorporated into the contract. These have an impact on the level of benefits that are delivered and the relative priorities between the beneficiaries.

A wide range of studies around the world have observed significant efficiency improvements that arise from franchising.

INTERNATIONAL EXAMPLES: SAVINGS ACHIEVED THROUGH COMPETITIVE TENDERING

There are numerous examples worldwide of the upfront cost and efficiency savings achievable through competitive tendering. As noted by Hensher et al., after contracts were put to tender in 1995, bus services in Britain experienced unit cost reductions of 50-55 per cent as patronage and farebox recovery increased. The United States bus industry was also able to realise substantial cost savings of between 30-46 per cent.^{8,9}



⁷ For further information, please refer to the 2012 L.E.K. /TTF publication *Public Transport, Private Operators*.

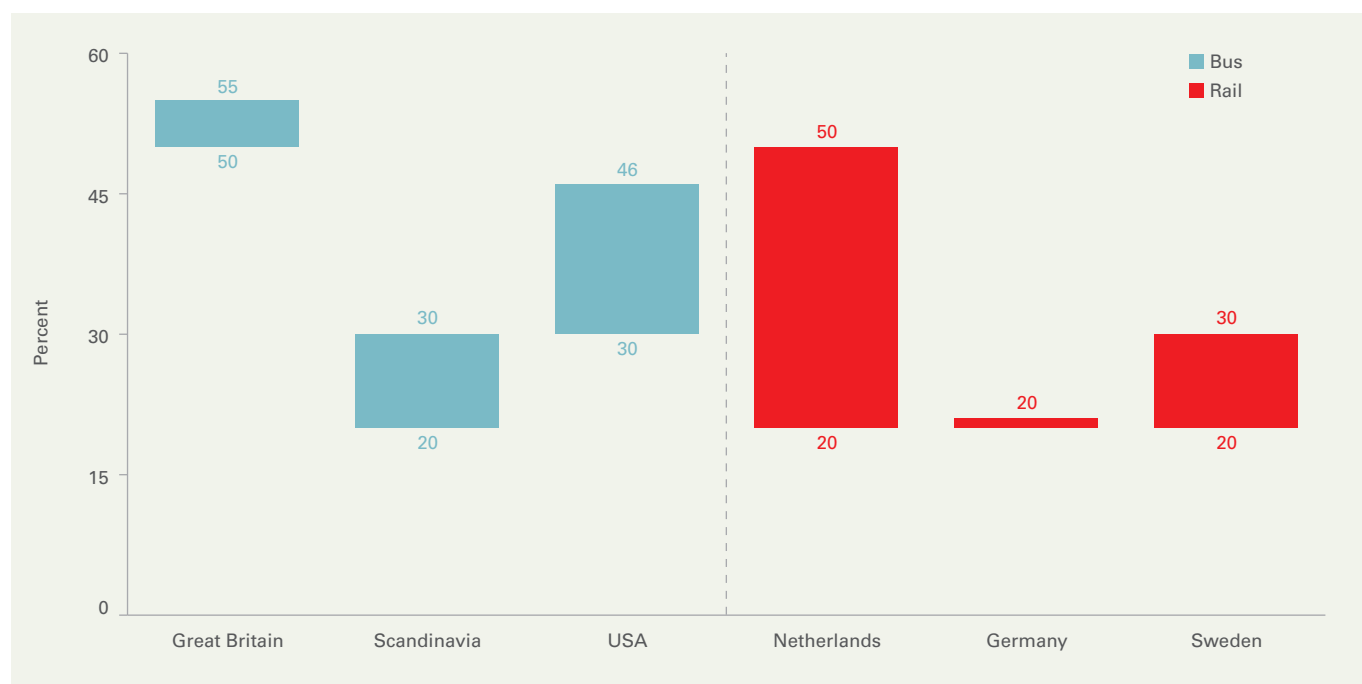
⁸ Cited in UK DfT Rail Value for Money Study 2010 p34, citing EU Conference of Ministers of Transport: Competitive Tendering of Rail services 2007.

⁹ A Hensher, I Wallis, Competitive Tendering as a Contracting Mechanism for Subsidising Transport: The Bus Experience, *Journal of Transport Economics and Policy* (2005).

Figure 7 summarises the range of savings realised by various bus and rail industries internationally. Efficient operation is particularly important in a public transport context as a one per cent reduction in operating costs has approximately two to three times the impact on an operator's cost position as a one per cent increase in farebox revenues.

On the basis of both Australian and international experience there is very strong evidence that transitioning from government run to privately run services has the potential to deliver significant cost reductions for government.

Figure 7: Unit cost reduction range from franchising (per cent)



Source: D.A. Hensher. I.P. Wallis, Competitive Tendering as a Contracting Mechanism for Subsidising Transport – The Bus Experience, Journal of Transport Economics and Policy, 2005; UK DfT Rail Value for Money Study (2010)

CASE STUDY IMPROVING PUBLIC TRANSPORT OUTCOMES THROUGH FRANCHISING AND PARTNERING

Transit Systems (Transit) is an Australian-based bus operator that has a strong history of delivering public transport services on behalf of government and managing the transition from publicly owned and operated services to private operations. Transit has undertaken government to private contract transitions in Perth (Swan Transit), Adelaide (Torrens Transit), Sydney (Transit NSW Liverpool) and more recently in Darwin (Territory Transit).

Swan Transit – Canning Contract

Swan Transit was established in 1995 to bid on Transperth urban bus contracts. Bus operations commenced with the Midland contract in eastern Perth in January 1996. Transit was awarded two further contracts during 1996 including the Canning and Southern River contracts which were both operated by the publicly owned operator.

These two contracts served major routes between the Perth Central Business District (CBD) and the south eastern suburbs, had a heavily unionised workforce and, in the case of the Canning contract area, lacked critical infrastructure. Notwithstanding these issues, positive outcomes were delivered for customers through:

- Less industrial action that could have disrupted services for commuters through a new award negotiated and implemented in 1996 through a co-operative process;
- Increased investment in infrastructure with the design and construction of new depots at Canning Vale in 1996 (delivered during the transition period between contract award and the commencement of operations), and at Beckenham in 2001; and
- An effective service design partnership with Transperth that delivered:
 - A major redesign of services to better utilise the Kwinana Freeway and develop cross-suburban links to Cannington (1998);
 - Expansion of services to the new areas of Atwell and Canning Vale, and new cross-suburban links to Cannington and Maddington (1999);
 - A shift in emphasis of services in Gosnells and Maddington from direct City services to rail feeder services (2000);
 - A complete redesign of services with the implementation of the Southern Suburbs railway (2007); and
 - A process of continuous improvement to services on the South St corridor to match a greater than 60 per cent patronage growth between 2008 and 2013.

Torrens Transit – East-West Contract

Torrens Transit began operations in 2000 with the East-West and City Free contract areas.

After commencing operations in Adelaide, Torrens Transit worked with the Department of Transport to reverse the long-term downward trend of public transport patronage.

In August 2005, the most extensive series of service changes implemented in Adelaide for the past 20 years occurred in the East-West and Outer North-East (O-Bahn) contracts. These include the introduction of a new seven-day, high frequency link to the Adelaide Airport, a doubling of off-peak service frequencies to Flinders University and the Mawson Lakes campus of the University of South Australia, a doubling of off-peak services on three corridors feeding the O-Bahn and a doubling of Sunday services on 14 corridors. These changes were implemented at no additional cost to government.

Competitive Tendering Contract Success – Swan and Torrens Transit

Figures 8 and 9 outline Transit's performance on the Canning Contract in Perth and the East-West Contract in Adelaide over the ten year period from the privatisation of the operations.

In both examples there was a marked decrease in cost to government per service kilometre immediately post the implementation of competitive tendering. In addition, there is evidence of improved service delivery for customers (as shown by the sustained long term trend of improved patronage per service kilometre) while the cost burden to taxpayers for the delivery of services has reduced. Transit achieved these results despite the logistical complexities of transitioning from government to private operations, the challenges with a competitive labour market environment and the limited available budget for service improvements in both jurisdictions.

These two case studies demonstrate how a private operator can partner with government to improve public transport outcomes through competitive tendering and a partnership based approach.

Figure 8: Canning Contract Performance – First 10 years from privatisation (1996-2006)

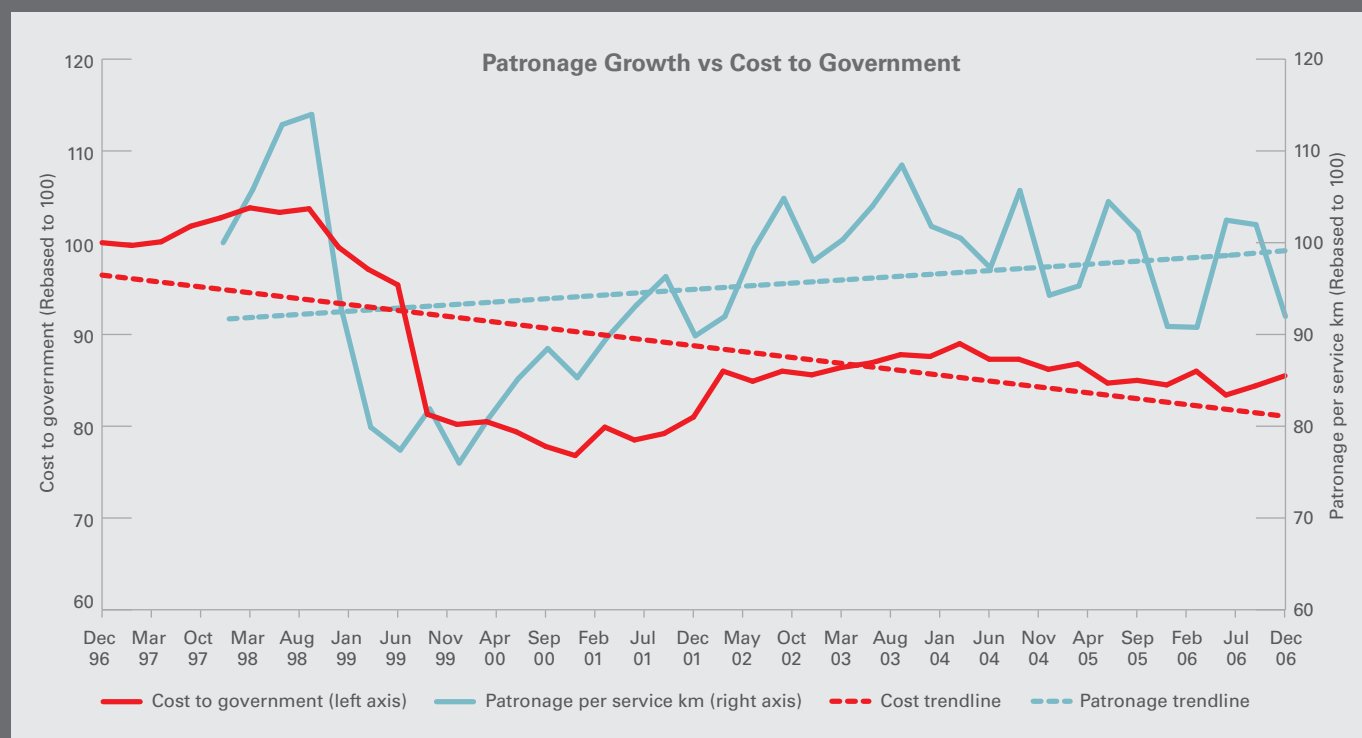
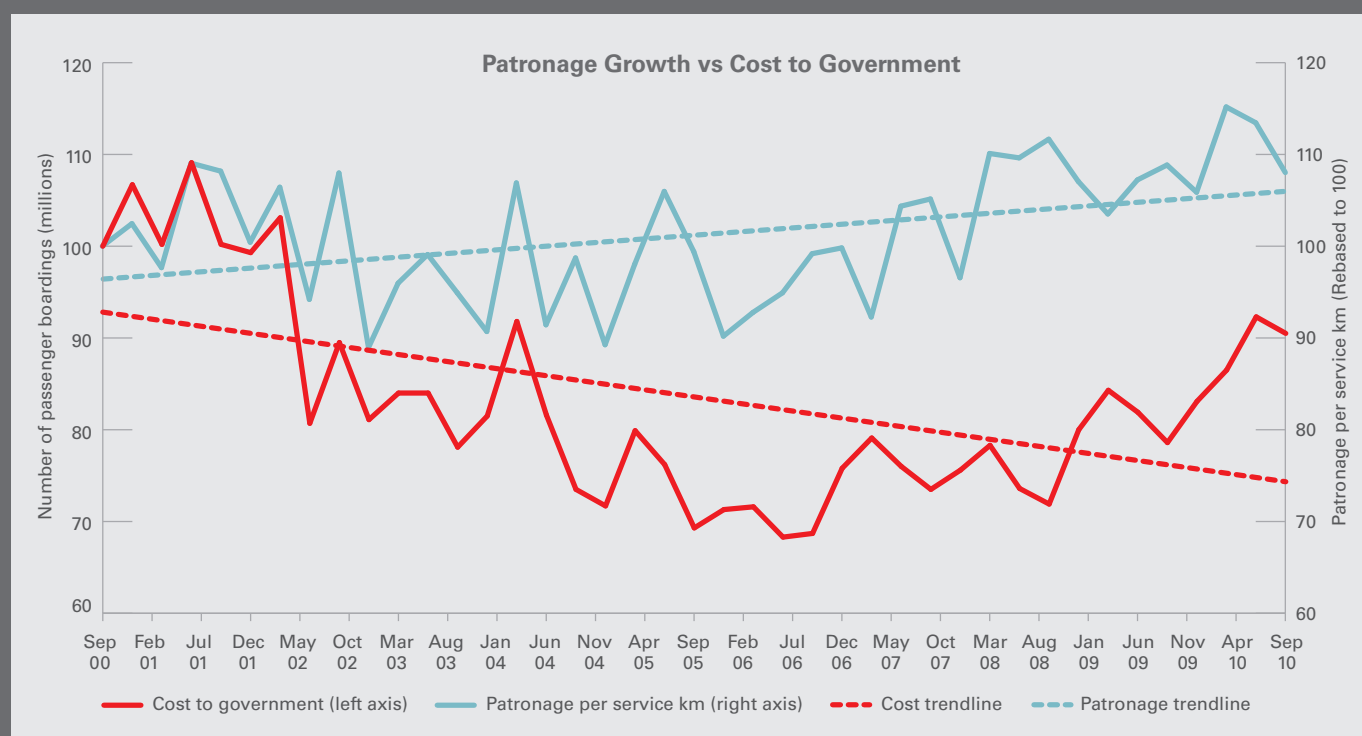


Figure 9: East-West Contract Performance – First 10 years from privatisation (2000-2010)

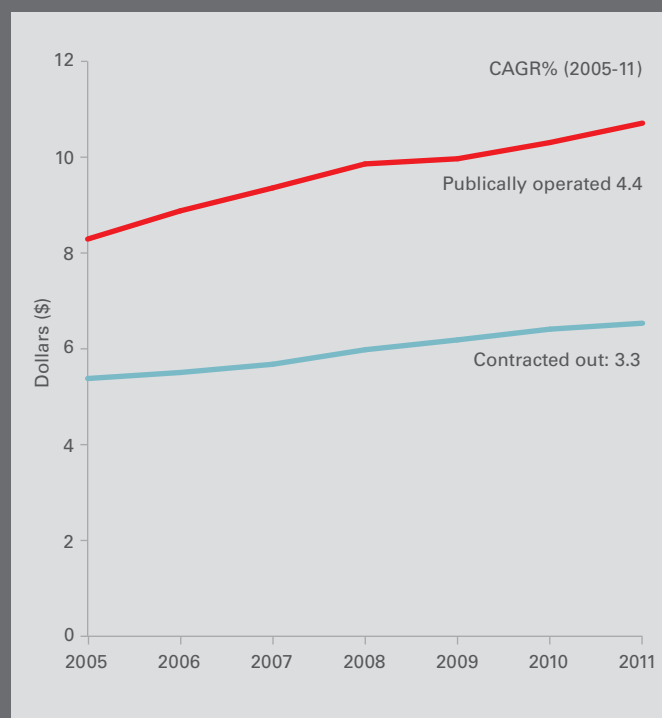


CASE STUDY US PERSPECTIVE

Contracting out bus operations to the private sector is a growing trend in the US, rising from eight per cent of spend on bus services in 2001 to reach 17 per cent in 2011. The key drivers of outsourcing are both the potential for cost savings and improved service quality. The superior cost and service performance of the private sector is evident in the national transport statistics, with private operators averaging thirty to forty per cent less per bus mile (Figure 10), and delivering much lower failure rates (Figure 11). These cost and performance advantages are achieved by the competition for the service contract, using more flexible labour (including part-time positions) and greater purchasing power for tyres, parts etc. Public Transport Authorities (PTAs) that keep operations in house do so because of pressure from unions, legal restrictions and caution over community reaction. However the steady growth in outsourcing suggests the benefits are being recognised by more PTAs each year.

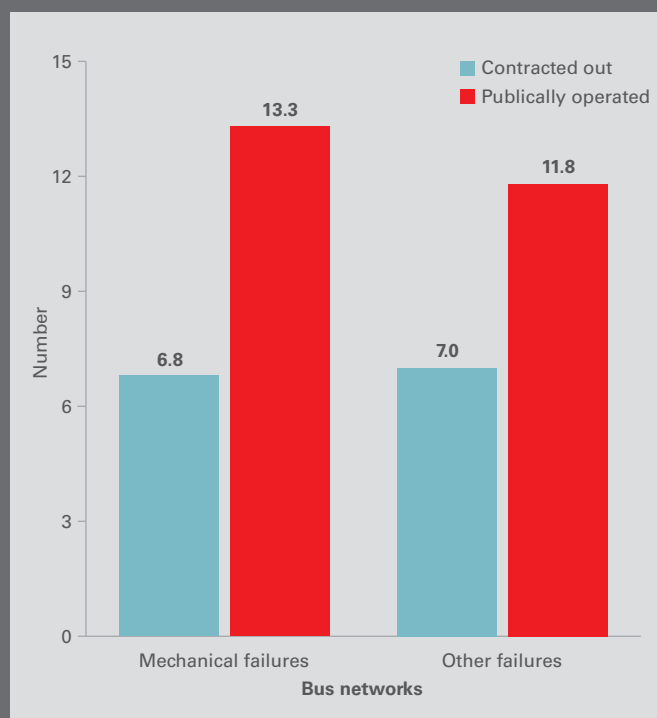


Figure 10: Average cost per revenue mile (2002-2011)



Note: Includes only bus networks.
Source: National Transit Database, L.E.K analysis

Figure 11: Failures per 100,000 miles (2011)



Source: National Transit Database, L.E.K interviews and analysis

4. BEST PRACTICES IN BUS CONTRACTING



4. BEST PRACTICES IN BUS CONTRACTING

With several decades of experience in designing private sector contracts, franchising models have become increasingly sophisticated over time. However the speed of change has been highly dependent on the extent to which government has had effective control over the sector.

In Adelaide and Perth, the contract model has matured through successive tendering processes over more than 15 years.

The pace of reform in Melbourne, Sydney and Brisbane has been more gradual, in large part due to the ownership of depots and buses by incumbent private sector operators.

While there is no perfect model, there is reasonable consensus on the elements of best practice contracting, as described in the table and discussed further below.

Table 3: Contract best practices

CONTRACT FEATURE	BEST PRACTICE
Term	Six to eight years with optional short term extensions. Ability to negotiate a second term if the operator exceeds performance benchmarks.
Size	Minimum of 75 to 100 buses.
Scope	Route-based contracts, clustered within a similar geographic area. Ideally designed to minimise dead running.
Depot access	Ideally the government owns or facilitates access to depots. Government should negotiate freehold or lease rights to any new depots built by operators.
Fleet	Ideally the fleet is owned, or substantially owned, by government, or leasehold access is facilitated. If no leasehold access, then tender processes need to allow additional time for procurement of vehicles prior to contract commencement. Asset maintenance standards should be prescribed for the bus fleet.
Tender preparation and sequencing	Provide advanced notice of intention to tender (for example, 12 months). Give bidders three to four months for their tender response. More time required if new depots or service changes are being proposed. Mandatory acquisition of buses and/or depots should have a transition time of more than 12 months.
Performance regime	Should cover punctuality, reliability, vehicle presentation, driver quality, customer satisfaction et cetera and include both penalties and incentives, calibrated to be meaningful, but not to cause financial distress.
Risk allocation	Gross cost with patronage incentives (or net cost with cap and collar).
Payment mechanism	Based on service hours (and/or service kilometres). Adjustments for changes in speed/congestion. Patronage incentive, sufficient to be meaningful (that is, 50 cents/passenger).
Operator concentration	Upper limit (for example, 30 to 50 per cent) on the proportion of services or patronage provided by one operator in a major city to provide performance comparisons and reduce risk in the event of one operator falling into financial distress.
Tender evaluation	Adopting a true “value for money” approach, striking the right balance between subsidy cost and service quality.

CONTRACT TERM

There is general consensus that the contract needs to be long enough to allow operators to both settle into the management of the business which can take one to two years, but more importantly to gain a return on investments made in improving the business. On the other hand, governments need to test the market periodically, to ensure that the contract is offering value for money, and to make sure that the operator remains focussed on delivering good performance and service innovation. Experience indicates that five years is too short, and 10 years is too long. Therefore six to eight year contracts are most common. Governments typically find it valuable to include optional one to two year extensions in the contract, so that the term can be extended without the need for re-negotiation. Including the option for a second term, subject to meeting performance benchmarks, can also have merits. Bus operators value length of contract quite highly, and this can and has been used as a positive incentive for change in reform negotiations.

FLEET SIZE

There is no hard and fast rule as to the size of an ideal bus contract. Typically a contract involving at least one or two depots is considered ideal, but the size of those depots can depend on a number of factors. In smaller or geographically constrained areas it may be logical to have a contract (and depot) of 20 to 40 buses. But typically depots closer to 100 buses are considered more optimal. Not surprisingly, larger international operators prefer bigger contracts (that is, up to 500 buses), which lend themselves to economies of scale, while family run businesses are comfortable with smaller contracts.

There is no quantitative evidence, to the best of our knowledge, that one particular scale is better than another, but industry opinion suggests contracts of a minimum of 75 to 100 buses or greater are attractive to most operators.

SCOPE

Most bus contracts are let as bundles of routes that sit in a similar geographic area. While area-based contracts did exist in the past, they have generally been replaced by route-based contracts. The most logical collection of routes will be that which optimises the operational efficiencies by minimising dead running, that is, the kilometres a vehicle runs “out of service” without passengers from the depot to the start of a route.

DEPOT ACCESS

Depot access/control is among the most critical aspects of an effective bus contracting regime. The scarcity and high value of land in middle and inner city areas means that whoever owns or controls a depot has a significant advantage in bidding for an operating contract. In instances where the bus depots are owned or controlled by the government (Perth, Adelaide, parts of Melbourne), contestability has been more readily achieved. However, where the bus depots are owned or controlled by private companies, it has proven much more difficult to attract new operators to bid and therefore run a competitive process, and this factor alone has stymied a number of attempts at reform. Greater security in relation to bus depot access is likely to assist in attracting high quality tenders from both domestic and international operators.

There are two very important implications arising from this:

- Firstly, it highlights the extreme importance of governments retaining long term ownership/control of bus depots in the event that operations like Sydney Buses, Brisbane Transport or ACTION buses are franchised.
- Secondly, where depots are currently owned by existing private operators, it highlights the importance of creating access to depots at the end of the contract term, as an essential ingredient in achieving effective contestability. There are a number of ways this can be done:
 - Purchasing the depots from private operators;
 - Negotiating access to depots under lease, at the end of a contract term (potentially in exchange for a longer or negotiated contract extension);
 - Ensuring that any new depots built include access rights for the government; and
 - In the event depot access is not facilitated through the tender (through either direct government ownership or access rights) then the transition date between contract award and contract commencement will need to be sufficiently long to ensure new entrants have sufficient time to procure the required assets.

While it is possible to run a competitive tender without depot access, the results in Sydney indicate that incumbent or adjacent operators may have an advantage under these circumstances (only one of the winning operators in Sydney was not already present in that market and has had to build a greenfield depot).



Image courtesy of Transdev

FLEET ACCESS

Access to the bus fleet is also important, but not as critical as depot access. Buses are more liquid assets in that there is an active second hand market, as well as a well-established supply chain for new buses. Given sufficient lead time, an incoming operator can organise a bus fleet, sufficient to operate a contract, until new assets are procured. Clearly this is easier for a smaller fleet than one of 200 to 500 buses.

Recognising this potential barrier, a number of governments have ensured that new buses acquired by operators incorporate step in rights for the government in the event of the operator losing the contract. The proportion of the bus fleet covered by such contracts has been progressively increasing over time.

With both buses and depots, the arrangements need to be designed carefully to avoid having to put the assets on the balance sheet of both the state and the operator. In some situations access rights can trigger such a requirement. There is also an interesting opportunity to use third-party ownership, so that neither the government nor the operator have the assets on their balance sheet. Such innovative structures are being actively explored in a number of cities.

TENDER PREPARATION AND SEQUENCING

Bidding for a substantial bus contract, involving significant commercial risk, is not a trivial undertaking. Operators therefore

need a sensible timeframe to decide whether to compete and prepare a thorough bid submission. Typically 12 months notice of intention to tender is helpful, as it allows operators to assess the potential opportunity well ahead of a formal franchise request for tender (RFT) being issued. This is particularly important if the operator would be expected to establish a depot or acquire fleet before commencement. In terms of the RFT timeframe, two months is generally considered to be the bare minimum to prepare a bid and three to four months is preferred if the contract is more complicated. The less the complexity of the contract, the shorter the timeframe can be.

Bus operators have limited bandwidth to mount multiple bids, so sequencing the release of RFT's thoughtfully can influence market interest in contracts.

Lastly, providing high quality information about the contract, for example, patronage and fleet details, is also important for market interest and calculating risk margins. If the information provided is comprehensive and the contract structure is clear and optimised, operators will be more likely to invest the time to bid, and less likely to require a high margin for uncertainty. Governments need to take sufficient time to prepare appropriate due diligence materials on buses, depots and staff arrangements before tendering. If required, interim contracts can help to establish the necessary preconditions towards competitive tendering.

PERFORMANCE REGIME

Penalties and incentives for performance should form part of an effective contracting regime. Designing such regimes has become easier as the quality of information about bus services has grown through use of GPS and automated ticketing systems.

Best practice performance regimes incorporate the following elements:

- Monitoring of on time running (OTR), ideally at several timing points along a bus route;
- Assessment of customer satisfaction, typically undertaken via survey, covering areas like vehicle presentation, staff announcements, passenger information et cetera; and
- Monitoring levels of fare evasion.

It can also be useful to include some flexible performance measures targeting specific outcomes that can be modified every one to two years.

Performance regimes typically include meaningful penalties, such that a decent proportion (10-20 per cent) of operators' margins is at risk if performance is poor. Private sector operators will place significant focus on factors that directly impact on their margins, and strive to improve their performance. It is not possible to create the same performance incentives for government-owned operators, as the government is both "customer" and "shareholder".

To avoid disputes, the data that underpins the performance regime needs to be routinely collected and not subject to dispute. Ideally performance data should be publicly disclosed.



RISK ALLOCATION

The main commercial risks in operation of a bus contract are revenue risk (including fares, patronage and fare evasion), operating costs, service volume and capital cost. Appropriate allocation of each of these risks is important in achieving an optimal contract structure.

In terms of revenue risk:

- Fare setting decisions almost always sits with governments, so governments need to bear that risk.
- Fare evasion risk is best managed by operators, so ideally they should manage that risk.
- Patronage outcomes are driven by a wide range of variables, including service frequency, fare levels, journey time, traffic congestion, petrol prices, employment growth et cetera. Only a small number of patronage drivers can be materially influenced by operators such as on-time running, vehicle presentation and announcements. Consequently operators should bear some, but not all of the patronage risk.

Operating costs, including labour costs, are best managed by bus operators themselves. Under most contracts, operators take full operating costs risk, except for fuel prices. A sensible cost indexation regime is required to allow for annual cost inflation.

Service volumes will rise and fall throughout a contract as timetables are altered or new services are introduced. These decisions are typically made by (or at least with the approval and support of) government, so service volume risk should ideally sit with government.

The main capital items are depots (as discussed previously) and the bus fleet. Bus fleet requirements will change, depending on patronage (particularly peak patronage), timetable changes, the efficiency of bus scheduling and the need for bus replacement. Buses can require major overhauls, which may also be capitalised. A further element of risk is the residual value of the bus at the end of its useful life for scheduled metro operations (around 20 years). Some of these expenditures arise through government decisions (for example, more services), and others by operator actions (for example, efficient scheduling). An effective contract therefore needs to apportion risk for different types of capital requirements between both government and operators.

After depot access, getting risk allocation right is among the most important elements of good contract design. Clarity over roles and responsibilities between franchisee and government is required for successful risk allocation.

PAYMENT MECHANISMS

The design of payment mechanisms is very closely linked to risk allocation. But different payment mechanisms can be used to achieve similar risk allocation. At a high level, contracts can be structured as net cost (where full revenue and cost risk sits with the operator), or gross cost (where just operating cost risk sits with the operator), or a hybrid of the two.

If some element of patronage risk is to be allocated to operators, this can be achieved either by:

- Net cost with floors and ceilings: Full allocation of patronage risk to operators within certain boundaries, but limiting exposure by way of ‘floors and ceilings’ to the level of revenue risk they should bear; or alternatively
- Gross cost with a patronage incentive: Payment of a patronage incentive (that is, 10-50c per passenger), which may be 10-30 per cent of the actual fare paid.

The patronage incentive mechanism is somewhat simpler, as it reduces the need to adjust for any fare policy decisions made by government.

Payments for operating costs are typically made on a gross cost basis, adjusted for inflation and with an allowance for changes in service levels at an agreed rate per kilometre (or bus hour).

Capital cost payment regimes can vary considerably depending on the risk allocation structure.

Payments for operating performance regimes should be large enough to be material, but not so large as to cause financial distress. Typically a maximum level of 10 to 20 per cent of the operator’s profit margin is sufficient.

Ideally the payment mechanism should be kept as simple as possible, otherwise administrative complexity can quickly outweigh the benefits of precision.

OPERATOR CONCENTRATION

There is a sensible argument for putting upper limits on the proportion of contracts or services in a city that can be held by one operator. Having multiple operators allows the government to benchmark service delivery in the local market, and also creates some healthy performance competition between operators. It also means that in the event of a financial default by one operator, another operator can be asked to temporarily oversee those services while a more orderly re-contracting process is undertaken. If an upper limit on operator concentration is to be set, then a measure based on the number of routes or proportion of patronage is preferable to a limit on contract numbers, as contracts can be very different sizes.

TENDER EVALUATION

When evaluating contract bids, it is imperative that a true “value for money” evaluation is adopted. Choosing an operator solely on the basis of lowest cost will likely lead to poor service outcomes. A good tender evaluation approach will balance cost with service quality dimensions to choose the best overall value for money offer. It is important to explicitly design the tender evaluation process to be able to undertake a meaningful comparison of offers on cost and service dimensions. The process for tender evaluation needs to continue to evolve towards a more mature and open process that involves a greater degree of dialogue and negotiation once the evaluation begins. The process should allow an incumbent or a new entrant an opportunity to explain their submission and can also benefit from more transparent and precise scoring of individual sections of the submission.

While designing effective bus contracts is not trivial, contracting regimes have been in place in many Australian states for nearly 20 years, and there is a great deal of accumulated knowledge available to learn from past mistakes and successes when designing a new contracting regime.

5. OPPORTUNITIES FOR REFORM



5. OPPORTUNITIES FOR REFORM

There are a number of potential reform opportunities for governments across the country. These can broadly be grouped into two categories:

- Contracting out existing government run bus services including:
 - Larger operators (Sydney Buses, Brisbane Transport, ACTION); and
 - Smaller operators (Metro Hobart, Newcastle Buses).
- Improving the effectiveness of existing private sector contracting regimes, particularly in Melbourne, Brisbane and Sydney.

CONTRACTING EXISTING GOVERNMENT RUN SERVICES

The key dimensions of the three large government run operators are shown in the table below.

While these operators rate well on customer service delivery, they are all considered to be significantly higher cost operations than equivalent services run by the private sector.¹¹

Table 4: Large government owned bus operators

OPERATOR	FLEET SIZE	PATRONAGE	OPERATING COSTS (\$M)
Sydney Buses ¹⁰	2,200	203m	\$640m
Brisbane Transport	1,200	78m	\$304m
ACTION	450	18m	\$120m

While these savings may take some time to deliver due to the difficulty of transitioning employee arrangements, it could be anticipated that over time, annual operating cost savings of greater than \$200 million per annum could be achievable from these opportunities. Furthermore the nature of contestable contracting should drive greater innovation, improved levels of customer service and better clarity of roles for government and operators.

If governments decide to pursue franchising of these operations, maintaining depot (and ideally fleet) ownership (and/or control) would be an essential ingredient of success.

The smooth transition of Sydney Ferries from public to private sector demonstrates contracting out can be achieved without major public back lash or undue media criticism if handled carefully.

IMPROVING THE EFFECTIVENESS OF EXISTING PRIVATE SECTOR CONTRACTS

While the contracting regimes in Adelaide and Perth are very mature, and optimised, those in Sydney, Melbourne and Brisbane would benefit from continued reform.

In Melbourne (for 70 per cent of services) and Brisbane, private bus contracts have never been tendered due to resistance by operators, operator control over depots and fleets and lack of government resolve to push through such a reform. Without periodic competition for these contracts,

governments have no effective mechanism for ensuring value for money. Likewise without the challenge of competition, operators have less incentive to innovate and improve their performance. Moving these significant operators to a fully contestable basis is likely to deliver some incremental cost savings, but also improve performance delivery.

Brisbane and Melbourne have also never undergone contract rationalisation, such as that undertaken in Sydney in 2004. This means there are more contracts than necessary, creating administrative inefficiencies, particularly now that many of the contracts are run by the same operators. There may also be a case to overhaul route allocation between contracts, to minimise dead running.

In Sydney the reform process is well advanced, having rationalised the contract areas in 2004, and pushed ahead with competitive tendering in 2012/13. The biggest remaining challenge is to create better depot access or control, which would improve the true level of competition for these contracts.

In early November 2015, the NSW Government announced that it will be looking to the private sector to plan, deliver and operate Newcastle buses, ferries and the new light rail line in an integrated network franchise. Transport for Newcastle has been set up to be the entity responsible for the management of the integrated network. This is a potential model that governments in other jurisdictions may wish to follow given its success globally in cities such as Tours and Lyon in France.

¹⁰ Figures include both Sydney and Newcastle buses

¹¹ Sydney buses has begun to reduce its operating costs during 2013/14, somewhat closing the gap to the private sector

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