

Legislative Council Panel on Transport

Fare Increase Applications by Franchised Bus Companies

Purpose

The Kowloon Motor Bus Company (1933) Limited (“KMB”), the Long Win Bus Company Limited (“LW”) and the New Lantao Bus Company (1973) Limited (“NLB”) have submitted applications for fare increases. This paper provides information about the bus fare adjustment arrangement and the franchised bus operations of these three companies. KMB, LW and NLB representatives will brief Members on their fare increase applications at the meeting of the Panel on Transport on 22 February 2008. Members are invited to comment on these applications.

Background

2. KMB, LW and NLB applied for fare increases of 9%, 5.9% and 7.24% respectively. KMB last increased its fares on 1 December 1997 by an overall weighted average rate of 7% whereas NLB last increased its fares on 1 April 1998 by an overall weighted average rate of 9%. LW started to operate a bus network serving the Airport at Chek Lap Kok and North Lantau to and from the New Territories since mid 1997. Its fares have not been adjusted since then.

Bus Fare Adjustment Arrangement

3. As stated in the Legislative Council Brief issued in January 2006, the Chief Executive-in-Council (“CE-in-Council”) approved on 10 January 2006 the following bus fare adjustment arrangement:

- (a) in assessing franchised bus fare adjustment applications for the purpose of making recommendations to the CE-in-Council, the Administration should continue to take into account a basket of factors in the Modified Basket of Factors (“MBOF”) approach as endorsed in December 2000, which include -
 - (i) changes in operating costs and revenue since the last fare adjustment;

- (ii) forecasts of future costs, revenue and return;
 - (iii) the need to provide the operator with a reasonable rate of return;
 - (iv) public acceptability and affordability; and
 - (v) quality and quantity of service provided;
- (b) the MBOF approach should be modified as follows -
- (i) a formula (supportable fare adjustment rate = $0.5 \times \text{Change in Wage Index} + 0.5 \times \text{Change in Composite Consumer Price Index ("CCPI")} - 0.5 \times \text{Productivity Gain}$) should be included as an additional factor in the MBOF approach to enable upward and downward fare adjustments. The formula should not operate as an automatic determinant of the fare adjustment outcome; there should be flexibility in applying the MBOF approach in considering bus fare adjustment;
 - (ii) in considering the reasonable rate of return to franchised bus operators, reference should be made to the Weighted Average Cost of Capital ("WACC") of the bus industry;
 - (iii) in considering public acceptability and affordability of bus fare adjustment, reference should be made to the magnitude of change in median household income, in addition to the existing reference to changes in CCPI; and
- (c) the introduction of the fare adjustment formula as an additional factor of the MBOF approach, the reference to median household income and WACC as set out in paragraph (b) above would take effect on 10 January 2006, and thereafter from the date of the last fare adjustment. All factors under the existing MBOF approach would be applied on a continual basis with reference to the date of the last fare adjustment, or, for franchised bus operators which have not adjusted fares before, the date of commencement of its operation.

Fare Adjustment Formula

4. As stated in the above-mentioned Legislative Council Brief, the formula in paragraph 3(b)(i) above will not operate as an automatic determinant of the bus fare adjustment outcome. We will use the outcome of the formula as a reference indicator in considering whether the fare adjustment rate is supportable and justifiable at a given juncture. The CE-in-Council will continue to retain the ultimate control in determining bus fares as currently provided in the Public Bus Services Ordinance (Chapter 230) to ensure all relevant factors under the MBOF approach will continue to be considered.

5. In the formula, staff cost for the franchised bus industry is reflected by the nominal wage index for the transport sector published by Census and Statistical Department (“C&SD”) quarterly. The remaining cost components of bus operators are to be reflected by CCPI published by C&SD on a monthly basis. As for the productivity gain, 50% of it was set as 0.3 per annum. Based on the CCPI for December 2007 and the wage index for the transport sector in the third quarter of 2007, the outcome of the formula is +3.91%, details of which is as follows –

$$0.5 \times 6.022\%¹ + 0.5 \times 2.947\%² - 0.3\% \times 23/12³ = 3.91\%$$

The above outcome of the formula is for present reference. When we continue to process the fare increase applications from the bus companies, we will update the outcome based on the updated CCPI and nominal wage index for the transport sector to be published.

Public Acceptability and Affordability

6. In considering public acceptability and affordability of bus fare adjustment, reference is made to the magnitude of change in monthly median household income (“MMHI”) published by C&SD quarterly. The MMHI has increased by 2.3% from the first quarter of 2006 to the third quarter of 2007. Similarly, we will make reference to the updated MMHI when we continue to process the fare increase applications from the bus companies.

¹ Change in CCPI from January 2006 to December 2007.

² Change in wage index for the transport sector from the first quarter of 2006 to the third quarter of 2007.

³ Productivity gain for the period from 10 January 2006 to December 2007.

Financial Viability and Performance of Bus Operators

7. The Legislative Council Brief that we issued in January 2006 has stated that the Administration will continue the practice for the bus industry of not setting a guaranteed minimum level nor a ceiling of rate of return. Neither will we prescribe a specific rate of reasonable return for all bus operators given circumstances and operating conditions vary among them.

8. In assessing the reasonable rate of return to bus operators, we will make reference to the WACC of the bus industry which can better reflect the prevailing economic situation and operating environment of the industry. The WACC is the average cost of debt and equity weighted by their respective proportion in the bus industry as a whole. It is derived based on an established and widely used formula which takes into account financial data of the market reflecting the cost of debt and equity. The WACC calculated for the bus industry is 9.7%.

9. To assess the financial performance of the bus operators, our consideration is to ensure they will have sound financial capability in providing efficient and quality public bus services. Following the established practice under the MBOF approach, we will consider the changes in operating costs and revenue since the last fare adjustment as well as the forecast of operating costs, revenue and return to have a clear and fair assessment of the operators' financial performance.

Consultation with the Transport Advisory Committee ("TAC") and Panel on Transport

10. Under the bus fare adjustment arrangement, the Administration would continue the practice of consulting TAC and the Panel on Transport on the bus fare adjustment applications before submitting its recommendation to the CE-in-Council.

Service Performance

KMB

11. As at end 2007, KMB operated 398 franchised routes with a fleet of 4,027 buses and employed about 12,000 staff. KMB has improved its fleet since its last fare adjustment on 1 December 1997 by installing

Octopus auto-payment system and bus-stop announcement system on all of its buses. At end 2007, the average age of KMB's fleet was 9.3 years with 94% buses air-conditioned. Since its last fare adjustment, KMB's average daily patronage increased from 2.83 million in 1998 to its peak of 3.11 million in 2002, and gradually decreased to 2.76 million in 2007.

12. On the environmental side, as at end 2007, 87.3% of KMB's fleet was using Euro emission standard engines and the company will progressively scrap the remaining pre-Euro buses. To further improve the environmental performance of its fleet, KMB is retrofitting diesel particulate filters ("DPFs") on its buses of Euro II and Euro III emission standards for completion by end 2009.

13. On the safety side, KMB's accident rate has remained below 3.3 accidents per million vehicle-km for the past three years⁴ whereas the average rate for the past three years⁴ for all franchised bus companies is 3.6. Before the CE-in-Council granted the existing franchise to KMB in January 2006, the company had undertaken to install black boxes⁵ on its whole fleet. Up to end 2007, 79.4% of KMB's buses have been equipped with black boxes. It plans to complete the installation exercise by end 2008.

LW

14. As at end 2007, LW operated 18 franchised routes with a fleet of 155 buses and employed about 440 staff. The average age of LW's fleet was 8.9 years, with 100% buses air-conditioned and equipped with Octopus auto-payment system and 97% with bus-stop announcement system. LW's average daily patronage increased from 39,300 in 1998 to 75,800 in 2007.

15. On the environmental side, 98% of LW's fleet was using Euro-II or III emission standard engines as at end 2007. Only three buses of its fleet were of pre-Euro emission standard although equipped with diesel catalytic converters and LW plans to scrap them within 2008. To further improve the environmental performance of its fleet, LW plans to retrofit DPFs on all its buses of Euro II and III emission standards by end 2009.

⁴ The figures for accidents per million vehicle-km in 2005 and 2006 are final whereas the figure for 2007 is provisional.

⁵ Electronic tachograph installed on vehicles is commonly known as "black box". It records the operation data of the vehicle, such as journey speed, journey time, distance travelled, bus tilting angle, acceleration and deceleration, door opening, etc. It can be used for monitoring the drivers' performance and accident investigation.

16. As regards safety, LW's accident rate has remained below 1.6 accidents per million vehicle-km for the past three years⁶. All LW's buses have been installed with black boxes.

NLB

17. As at end 2007, NLB operated 16 regular and 6 special service franchised routes serving Lantau Island and one route between the Shenzhen Bay Port and Yuen Long West Rail Station. It had a fleet of 94 buses and employed about 240 staff. The average age of NLB's fleet was 7.2 years. The company has been improving its buses by converting its whole fleet to air-conditioned buses and installing bus-stop announcement system on 15% of its buses. The average daily patronage of NLB increased from 17,000 since its last fare increase in 1998 to 44,200 in 2007.

18. On the environmental side, 98% of NLB's fleet was using Euro-II, III and IV emission standard engines as at end 2007. Only two buses of its fleet were of Euro-I emission standard equipped with diesel catalytic converters. To further improve the environmental performance of its fleet, NLB has retrofitted DPFs on all buses of Euro II and III emission standards where technically feasible.

19. As regards safety, NLB's accident rate has remained below 2.4 accidents per million vehicle-km for the past three years⁶. Before the CE-in-Council granted the existing franchise to NLB in January 2006, the company had undertaken to install black boxes on its whole fleet. Up to end 2007, 59% of NLB's buses were equipped with black boxes. It plans to complete the installation exercise by end 2009.

Cost Saving Measures of the Franchised Bus Companies

20. In the face of the increasingly difficult operating environment in recent years due to rising operating costs like fuel and staff costs as well as tunnel tolls and competition from other public transport modes, the three franchised bus companies have taken various cost saving measures. These include bus rationalisation and improvement of fleet utilisation to improve network efficiency, etc. NLB has also been approved by the

⁶ The figures for accidents per million vehicle-km in 2005 and 2006 are final whereas the figure for 2007 is provisional.

Administration to share the refuelling facilities with the Citybus Limited at the latter's depot in Tung Chung.

Advice sought

21. Members are invited to provide comments on the fare increase applications made by KMB, LW and NLB.

Transport and Housing Bureau
Transport Department
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