

ITEM FOR FINANCE COMMITTEE

HEAD 186 – TRANSPORT DEPARTMENT

Subhead 700 General non-recurrent

New Item “Helping measures to assist the operation of six major outlying island ferry trunk routes”

Members are invited to approve a new commitment of \$114,963,000 for providing further helping measures to six major outlying island ferry trunk routes.

PROBLEM

We need to provide further helping measures to tackle the chronic problems faced by outlying island ferry services in order to enhance their long-term financial viability and maintain fare stability.

PROPOSAL

2. The Commissioner for Transport (C for T), with the support of the Secretary for Transport and Housing, proposes to create a new commitment of \$114,963,000 for providing further helping measures to six major outlying island ferry trunk routes during the new license period from 1 April/1 July 2011¹ for three years to alleviate the pressure of fare increase.

/JUSTIFICATION

¹ The existing license period of five major trunk routes (namely Central – Cheung Chau route; Inter-Islands route serving Peng Chau, Mui Wo, Chi Ma Wan and Cheung Chau; Central – Peng Chau route; Central – Yung Shue Wan route; and Central – Sok Kwu Wan route) will end on 30 June 2011 while that of the sixth major trunk route, namely Central – Mui Wo route, will end on 31 March 2011. Therefore, the new license period for the five major trunk routes will start from 1 July 2011 for three years and that for Central – Mui Wo route will start from 1 April 2011 for three years.

JUSTIFICATION

Need for helping measures

3. Our basic premise is to follow as far as possible the existing policy of allowing the private sector to operate public transport services on commercial principles. However, ferry services are unique in that they are the only means of transport for some of the outlying islands. As such, the Government has a role in ensuring the continuation of such essential services through enhancing their long-term financial viability and maintaining fare stability.

4. In order to enhance the financial viability of the ferry services, the Government has taken various measures to enable ferry operators to reduce their operating costs and increase non-fare box revenue. These measures include –

- (a) taking over the responsibility of pier maintenance;
- (b) waiving fuel duty;
- (c) reimbursing pier rentals and exempting vessel license fees for ferry services under the Elderly Concessionary Fare Scheme;
- (d) obtaining the Town Planning Board's approval to relax land uses at Central Piers No. 4, 5 and 6 so that the operators can sublet the upper deck of these piers for commercial activities such as restaurants, fast food shops, retail shops and service trades; and
- (e) streamlining the subletting approval procedures to help generate non-fare box revenue for cross-subsidising the ferry operation so as to alleviate pressure for fare increase.

Despite these measures, four² of the six major trunk routes mentioned in paragraph 2 above needed to go through a second round of tender in the 2008 license tendering exercise in order to reduce the magnitude of fare increases during the new license term from 2008 to 2011. Furthermore, special helping measures had to be offered for these four trunk routes at that time (see Enclosure for details).

Encl.

/Chronic

² The four routes are Central – Mui Wo route, Central – Peng Chau route, Central – Yung Shue Wan route and Central – Sok Kwu Wan route.

Chronic problems faced by the outlying islands ferry services

5. In May 2008, the Government undertook to conduct a review on the outlying island ferry services with a view to enhancing the long-term financial viability of these services and maintaining fare stability. We have completed the review on 14 outlying island ferry routes which are regular passenger services licensed under the Ferry Services Ordinance (FSO).

6. During the review, we have carefully examined and analysed the chronic problems faced by the outlying island ferry services, which are essentially two-fold: lack of growth in demand and highly volatile fuel cost. On the demand side, patronage has been relatively small. The average daily patronage of the 14 outlying island routes is about 64 000, accounting for 0.6% of the total public transport ridership. The population projection up to 2012 does not support much growth in demand. On the cost side, the major components are staff remuneration, maintenance cost and fuel cost. Whereas fuel cost constitutes a significant portion of the total operating expenditure, it is outside the operators' control and its high volatility puts the business at high risk.

7. Given the above long-term structural problems faced by the outlying island ferry services, there is not much room for further revenue generation or cost containment. At the same time, we recognise the increasing expectations of the community and the travelling public on the reliability and quality of service. While fare increases could help sustain the financial viability of these services, such increases, which would likely be well above the rate of general inflation, would add burden to the commuters.

Need for further helping measures to sustain financial viability

8. In view of the above review findings and the prospect of further escalating operating costs, we consider that the existing helping measures are not enough to solve the chronic problems faced by the operators. There is a need to step up the measures.

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9. In formulating further helping measures to support the ferry services, we have borne in mind the need for prudent use of public funds. Therefore, we aim to strike a balance between the need to support essential services which otherwise would not be financially viable on one hand, and the need to let individuals shoulder the appropriate responsibility for choosing to live on the outlying islands on the other. On this basis, we propose to limit the new measures to six major trunk routes only (instead of passenger ferry services in general) with a view to sharing some of the burden of the commuters when such a need arises. In effect, this would mean one route for each of the major islands except for Lamma Island where we propose to support two routes because of the geographical distance between Yung Shue Wan and Sok Kwu Wan.

Proposal

10. We propose to provide further helping measures to the six major trunk routes for alleviating part of the pressure of fare increase during the three-year new license period as follows –

- (a) extend the special helping measures (see Enclosure) currently provided to the four major trunk routes (see Note 2) to six major trunk routes (see Note 1) during the new license period; and
- (b) reimburse the actual vessel maintenance cost incurred by the operators of the six major trunk routes whenever there is still a justified case for fare increase during the new license period, after taking into account the helping measures in (a) above, in order to reduce the order of fare increases. By doing so, the Government aims to share part of the burden of the commuters by reducing the rate of fare increase by half (after netting off the rate of general inflation in the first place) through reimbursing the operators the vessel maintenance cost that has been incurred, provided that the share to be met by the Government can be contained on the basis of historical data of vessel maintenance costs.

Other options considered

11. We have explored various other options, including reducing cost through route and service rationalisation; replacing ferry service license with franchise to extend the license period; Government to purchase vessels for

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operators; contracting out of ferry services; and introduction of fuel-related mechanisms. Among these five options, the first three could not help the operators improve the long-term financial viability of the ferry services. Moreover, purchasing vessels would require huge capital expenditure. As regards the last two options, they would violate the Government's policy and have wide read-across implications. As such, all the above options are considered infeasible.

FINANCIAL IMPLICATIONS

Non-recurrent Expenditure

12. We estimate the expenditure of providing the helping measures for the six major trunk routes to be \$114,963,000, with the breakdown as follows –

	2011-12 \$'000	2012-13 \$'000	2013-14 \$'000	2014-15 \$'000	Total \$'000
(a) Provide special helping measures to six major trunk routes	7,285	9,014	9,014	1,729	27,042
(b) Reimburse vessel maintenance cost in respect of six major trunk routes	23,792	29,307	29,307	5,515	87,921
Total	31,077	38,321	38,321	7,244	114,963

13. Regarding paragraph 12(a) above, the estimated expenditure of \$27,042,000 is for providing the special helping measures to the six major trunk routes during the new license period. Such measures include reimbursing the ferry operators the annual vessel survey fee, the private mooring fee of the vessels, the water, electricity and cleansing charges, as well as the balance of operators' revenue foregone due to provision of elderly fare concessions (after netting off the amount of pier rental reimbursement and vessel license fee exemption).

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14. Regarding paragraph 12(b) above, the estimated expenditure of \$87,921,000 is for reimbursing the actual vessel maintenance cost incurred with a view to reducing the rate of any justified fare increase by half after netting off the rate of general inflation since the last fare increase. The cost estimate is derived on the basis of the vessel maintenance costs in past years provided by the existing operators. This estimate will serve as the ceiling for reimbursement of the cost for vessel maintenance in the event the actual cost incurred exceeds the ceiling. Maintenance costs will only be reimbursed if and when fare increases are justified, and only actual expenses already incurred will be reimbursed, subject to the ceiling.

IMPLEMENTATION PLAN

15. The existing license period of Central – Mui Wo route and the remaining five major trunk routes will end on 31 March 2011 and 30 June 2011 respectively. We plan to conduct a tendering exercise as soon as possible with a view to selecting suitable ferry operators for the operation of the six major trunk routes.

16. The vessel maintenance cost would only be reimbursed as and when a need arises. In essence, this means that if and when fare increases are considered justified by C for T for individual routes, the Government will reimburse the actual expenses already incurred as outlined in paragraph 14 above, with a view to reducing the fare increases by half after netting off the rate of general inflation since the last fare increase, subject to the ceiling. A mid-term review will be conducted during the three-year license period. If the review projects a reduction in operating costs, Transport Department (TD) may ask the operators to appropriately reduce the fare levels. During the new license period, operators will be required to submit audited financial statements at the end of each financial year to substantiate the actual expenditure incurred, and quarterly management accounts so that TD can monitor their financial position.

17. We shall review the effectiveness of these measures before the expiry of the new three-year license period.

PUBLIC CONSULTATION

18. We consulted the Legislative Council Panel on Transport on 23 April 2010. Members in general welcomed the proposal as a positive step to address the chronic problems faced by the outlying island ferry services. However, they also cautioned the Government that the maintenance costs of ferry operation should be carefully monitored in order to prevent abuse of Government subsidy. In addition, Members requested supplementary information concerning the review. To this end, an information paper has been submitted to the Panel in August 2010.

19. We launched a series of consultations immediately after our briefing for the Panel on 23 April 2010. During April to June 2010, we consulted the Transport Advisory Committee, the Traffic and Transport Committee of the Islands District Council as well as relevant Rural Committees, resident groups and the trade on our proposal. We also organised public consultation forums to collect the views of the residents of the outlying islands. In addition, TD uploaded information of the review and proposal onto its website for the public to express their views. During the consultations, most respondents supported the Government's proposal to help the major outlying island ferry services and generally welcomed the proposed helping measures for the six major trunk routes. TD also briefed the Traffic and Transport Committee of the Islands District Council on the proposed tender arrangements on 27 September 2010.

BACKGROUND

20. At present, there are 14 outlying island ferry routes which are regular passenger services, including the six major trunk routes. These services are licensed and regulated by C for T under FSO. A license is normally granted for a period of three years and could be extended for a further period or periods of up to three years, with the aggregate continuous period of license not exceeding ten years.

21. Two rounds of tender were conducted between mid-2007 and mid-2008 for the six major ferry trunk routes as the licenses had reached the ten-year maximum term permitted under FSO by mid-2008. The tenders were carried out amidst sharp increase in oil prices. In the face of escalating costs and strong reaction from the residents against service rationalisation, the only bid

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received for four of the six ferry routes including Central – Mui Wo, Central – Peng Chau, Central – Yung Shue Wan and Central – Sok Kwu Wan proposed to have fare increases of 30% to 50%. As a result, the routes had to be re-tendered with some relaxation of the service requirements as well as helping measures from the Government. The licenses were subsequently granted for the four routes with average fare increases reduced to a range of 5.5% to 23%.

22. In anticipation of increasingly high fares for ferry services and the difficulties that will be faced by operators in operating ferry services for outlying islands, the residents of the outlying islands and Members of the Legislative Council asked the Government to devise measures to ensure the sustainability of outlying island ferry services in the future. In May 2008, the Government committed to conduct a review to enhance the long-term financial viability of these ferry services and maintaining fare stability.

Transport and Housing Bureau
October 2010

**Special Helping Measures Currently Provided to
Four Major Outlying Island Ferry Trunk Routes**

The special helping measures for the three-year license period commencing from April 2008 for the Central – Mui Wo route and from July 2008 for the Central – Peng Chau, Central – Yung Shue Wan and Central – Sok Kwu Wan routes are –

- (a) waiving annual vessel survey fee and private mooring fee;
- (b) reimbursing pier water charge;
- (c) reimbursing pier cleansing and electricity charges subject to caps imposed by the Commissioner for Transport (C for T); and
- (d) reimbursing the balance of revenue forgone due to provision of elderly fare concessions after netting off the amount of pier rental reimbursement and vessel license fee exemption under the established arrangement subject to a cap imposed by C for T.
