For discussion
on 5 July 2013

FCR(2013-14)26

ITEM FOR FINANCE COMMITTEE

HEAD 186 – TRANSPORT DEPARTMENT
Subhead 700 General non-recurrent
New Item "Provision of Special Helping Measures for the Six Major Outlying Island Ferry Routes"

Members are invited to approve a new commitment of $190,359,000 for the continued provision of special helping measures for the six major outlying island ferry routes.

PROBLEM

We need to continue to provide special helping measures (SHMs) for the six major outlying island ferry routes in the next licence period from mid-2014 to mid-2017 to maintain the financial viability of the ferry services and alleviate the burden of fare increases on passengers.

PROPOSAL

2. The Commissioner for Transport, with the support of the Secretary for Transport and Housing, proposes to create a new commitment of $190,359,000 for the continued provision of SHMs for the six major outlying island ferry routes during the new licence period starting from 1 April/1 July 2014[1].

/JUSTIFICATION …..

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[1] The existing licence of "Central – Mui Wo" route will expire on 31 March 2014; the licences of the remaining five routes (i.e. "Central – Cheung Chau", "Inter-islands", "Central – Peng Chau", "Central – Yung Shue Wan" and "Central – Sok Kwu Wan") will expire on 30 June 2014. The new/extended licence for "Central – Mui Wo" route will start from 1 April 2014 and those for the remaining five routes will start from 1 July 2014. The licence period for all the six routes is three years.

JUSTIFICATION

Review on Outlying Island Ferry Services and the Provision of SHMs for the Major Outlying Island Ferry Routes

3. The Government conducted a review on ferry services for outlying islands in 2010. In the course of the review and formulation of the proposal, our principles and rationale are: (a) public transport services should be operated by the private sector on commercial principles; (b) the need to maintain long-term financial viability and fare stability of the public transport services; (c) the need for the Government to use public money prudently and to consider appropriate responsibility that should be borne by individuals; and (d) harbourfront planning considerations. Details are at Enclosure 1. Having regard to the above principles and rationale, we proposed providing SHMs for the operators of the six major outlying island ferry routes during the three-year licence period from mid-2011 to mid-2014 to further reduce operating costs and the magnitude of fare increases. With the SHMs provided by the Government, the average fare increases of these six routes in the three-year licence period were about 10%. If SHMs were not provided, the fare increases could be more than 20%.

Encl. 1

4. When the Government proposed providing SHMs for the operators of the six routes and consulted the Panel on Transport in 2010, the Government undertook to conduct a mid-term review to ensure the proper spending of public funds involved. The Panel on Transport was of the view that, if the review showed that operating costs were projected to be reduced, the Government should consider lowering the fare levels of the six routes. Subsequently, the Finance Committee (FC) approved a commitment of $114,963,000 in November 2010 for the implementation of SHMs for the six major outlying island ferry routes during the licence period starting from 1 April/1 July 2011 for three years. Details are set out in Enclosure 2.

Encl. 2

Outcome of the Mid-term Review

Financial Performance

5. In the course of the mid-term review, with reference to the management and financial reports submitted by the two operators, namely the New World First Ferry Services Limited (NWFF) and the Hong Kong & Kowloon Ferry Holdings Ltd. (HKK)[2], we have examined the financial performance of the six outlying island ferry routes in the first operating year (i.e.

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[2] NWFF operates “Central – Cheung Chau”, “Inter-islands” and “Central – Mui Wo” routes whereas HKK’s three subsidiaries operate “Central – Peng Chau”, “Central – Yung Shue Wan” and “Central – Sok Kwu Wan” routes respectively.

from mid-2011 to mid-2012) of the current three-year licence period [3] and projected their financial performance in the remaining two operating years.

6. The SHMs proposed by the Government in 2010 for the operators of the six routes (see paragraph 4 above) are implemented through the reimbursement on actual expenses of designated items subject to the financial caps. In the first operating year, the six ferry routes received a total reimbursement of about $37,005,000 from the Government under the SHMs. Details of the expenses are set out in Enclosure 2. It is estimated that the amount to be reimbursed to the ferry operators would reach the ceiling of $114,963,000 by the end of the current licence period. Based on this assumption, it is forecast that NWFF and HKK would only have a profit margin of below 5% for the entire licence period. If the SHMs were not provided for the current three-year licence period, there would be a loss margin of around 10% for both NWFF and HKK. The analysis shows that the SHMs are essential to maintaining the financial viability of the ferry services in the current licence period. It also shows that there is no case to adjust downwards the existing fares of these six routes for the rest of the licence period.

Operational Performance

7. We have also assessed the operational performance of the six ferry routes with reference to the complaint figures, passenger survey results and operational returns submitted by the operators. Findings show that the overall performance of the ferry services are satisfactory. Details are set out in
Encl. 3 Enclosure 3.

The Need for Continued Provision of SHMs in the Next Three-year Licence Period

8. The existing licences of the six ferry routes will expire in mid-2014. Based on the financial data of the first operating year, it is anticipated that the existing provision of $114,963,000 under the SHMs would be exhausted by the end of the current licence period. Indeed, it is noted that both incumbent operators had not been fully reimbursed for the relevant expenses/revenue foregone owing to the provision of elderly or child fare concessions as some items had exceeded the financial caps. According to our projection of the financial performance of the six ferry routes for the next licence period based on the current revenue and cost pattern (taking into account anticipated inflation), even with the

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[3] The mid-term review of the three-year licence period involves the operating performance of 18 months. The available financial data audited by auditors only cover those for a 12-month period (i.e. from mid-2011 to mid-2012) but they are accurate enough for the purpose of the mid-term review. This is because costs were generally stable throughout the past 18 months and the revenue was stable due to steady ferry patronage.

continued provision of SHMs at similar level, NWFF and HKK would not be able to achieve breakeven for the next licence period from mid-2014 to mid-2017 if there is no change in the existing fare levels. There is therefore a case for continued provision of SHMs and upward adjustment of the financial caps as appropriate to reflect the rising costs.

Proposal

9. Having regard to the principles and rationale as set out in paragraph 3 above, as well as the following data and considerations, the Government proposes to adjust upwards the financial caps for SHMs in the next three-year licence period to $190,359,000 (details are in paragraph 11 below) –

(a) the level of caps for expenses/revenue foregone of reimbursable items in the next three-year licence period should be adjusted upwards as appropriate based on the actual expenses/revenue foregone of the reimbursable items in the first operating year of the current licence period (i.e. from mid-2011 to mid-2012);

(b) the financial caps should also be adjusted in line with the projected inflation rate (11.9%[4]) for the three-year period; and

(c) there should be a 20% buffer provision to cater for the further upward adjustment of the financial caps so as to meet possible increase in operating costs due to factors which are difficult to predict at this stage (for example, the increase in statutory minimum wage on 1 May 2013 may indirectly impact on the vessel maintenance cost and various pier charges).

SHMs will be implemented through the reimbursement of actual expenses of designated items subject to the financial caps (see paragraph 11 below). Operators will be required to submit audited financial statements to the Transport Department (TD) at the end of each financial year for substantiating the actual expenditure incurred. In addition, they are also required to submit their quarterly management accounts so that TD can monitor their financial position. Besides, we will conduct a mid-term review during the three-year licence period.

Other Options Considered

10. We are actively planning the construction of additional floors at Central Piers Nos. 4, 5 and 6 to help generate non-fare box revenue for the six ferry routes. This would serve as long-term sustainable subsidies to the six routes. As it would take time to implement the project, it is anticipated that the six ferry routes for the next licence period from mid-2014 to mid-2017 could

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4 The projected inflation rate is calculated based on the projected accumulated changes of the Composite Consumer Price Index (CCPI) from 2011-12 to 2014-15.

hardly benefit from this project. As such, it is not a viable alternative to the proposed enhanced SHMs. Besides, we have explored other options, including fuel and staff cost subsidy, and Government funding the capital cost of vessels procurement and contracting out the services. These options are not viable because they go against the Government's established policy that public transport services should be run by the private sector in accordance with prudent commercial principles. If pursued, they would have read-across implications.

FINANCIAL IMPLICATIONS

Non-recurrent Expenditure

11. We estimate the expenditure of providing the SHMs for the six major ferry routes to be $190,359,000 in the next three-year licence period, with the breakdown as follows –

		2014-15 $'000	2015-16 $'000	2016-17 $'000	2017-18 $'000	Total $'000
(a)	reimbursing the operators of the ferry services concerned for the annual vessel survey fee and private mooring charge	381	524	524	142	1,571
(b)	reimbursing the pier electricity, water and cleansing charges	2,490	4,505	4,505	2,016	13,516
(c)	reimbursing the balance of revenue foregone due to provision of elderly fare concessions after netting off the amount of pier rental reimbursement and vessel licence fee exemption under the established arrangement	3,386	6,324	6,324	2,938	18,972

/(d) …..

		2014-15 $’000	2015-16 $’000	2016-17 $’000	2017-18 $’000	Total $’000
(d)	reimbursing the vessel maintenance cost	3,890	31,909	31,909	28,020	95,728
(e)	reimbursing the revenue foregone due to provision of child fare concessions	4,298	7,830	7,830	3,531	23,489
(f)	reimbursing the vessel insurance cost	839	1,119	1,119	280	3,357
(g)	re-launching “Visiting Scheme to Outlying Islands”	500	1,000	500	-	2,000
	Estimated Commitment	15,784	53,211	52,711	36,927	158,633
	Total Commitment including an Additional 20% Buffer Provision	**18,941**	**63,853**	**63,253**	**44,312**	**190,359**

12. On paragraph 11(a) above, the estimated expenditure of $1,571,000 is for reimbursing the ferry operators for the annual vessel survey fee and private mooring charge during the next licence period. The estimated expenditure is the anticipated actual fee level of these items.

13. On paragraph 11(b), (d) and (f) above, the estimated expenditures of $13,516,000, $95,728,000 and $3,357,000 are for reimbursing the ferry operators for the pier electricity, water and cleansing charges, vessel maintenance cost and vessel insurance cost. The estimated expenditures are financial caps derived from the actual expenses of the six ferry routes in the first operating year of the current three-year licence period, with concurrent reference to the projected change of CCPI in subsequent years up to the first operating year of the next three-year licence period.

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14. On paragraph 11(c) and (e) above, the estimated expenditures of $18,972,000 and $23,489,000 are for reimbursing the ferry operators for the revenue foregone due to the provision of elderly and child fare concessions. The estimated expenditures are financial caps derived from the total actual revenue foregone of the six ferry routes owing to the provision of elderly and child fare concessions in the first operating year of the current three-year licence period.

15. On paragraph 11(g) above, the estimated expenditure of $2,000,000 is a financial cap intended for the implementation of the Visiting Scheme to Outlying Islands. The scheme provides free ferry rides to eligible persons from schools, non-governmental organisations, community and local groups, etc. to encourage them to organise activities to the outlying islands served by the six ferry routes.

IMPLEMENTATION PLAN

16. The two incumbent operators (i.e. NWFF and HKK)[5] have indicated interest in applying for extension of their existing ferry service licences for three years if the Government maintains the SHMs policy and offers appropriate upward adjustment of the financial caps for the SHMs. The services provided by the incumbent ferry operators are generally satisfactory. Given the operating difficulties faced by the six ferry routes, even if we receive bids during public tender exercise, they may not be favorable and some may even ask for huge fare increases. As such, we plan to pursue the extension of the existing licences to maintain the services of the six ferry routes. Subject to the funding approval of FC, TD would formally kick-start the discussions with the incumbent operators on the extension of licences.

17. Both NWFF and HKK have expressed that the fare increase rate would be mild, should there be a need to apply for fare increase in future. In any event, the Government would carry out its stringent gate-keeping duties in handling fare increase applications. Fare increase applications must be supported by strong and substantive justifications. Public affordability would also be taken into account when considering the increase rate.

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5 In accordance with section 29(2) of the Ferry Services Ordinance, "[t]he Commissioner [for Transport] may, at the request of the licensee, during any period while the licence is in force, extend the period of the licence for a further period or periods not exceeding 3 years at any one time, so that the period for which the licence was granted together with all extensions thereof shall not in any case exceed in the aggregate a period of 10 years". As the current licences of the six routes started from mid-2011, further extension of these licences for three years would still meet the ten-year aggregate period rule.

PUBLIC CONSULTATION

18. We consulted the Panel on Transport on 24 May 2013. Members generally supported the proposal. However, some Members requested the Government to study other long-term measures to address the perennial problem of financial viability of the outlying island ferry services. Such measures include extending the current three-year licence period, fuel and staff cost subsidy, as well as Government funding the capital cost of vessels procurement and contracting out the services. We are open to the suggestion of extending the current three-year licence period. We would look into the suggestion and consult the trade. For the proposed fuel and staff cost subsidy, and Government funding the capital cost of vessels procurement and contracting out the services, as explained in paragraph 10 above, these options go against the Government's established policy that public transport services should be run by the private sector in accordance with prudent commercial principles. If pursued, they would have read-across implications. We also consulted the Transport Advisory Committee on 28 May 2013. Members supported the proposal.

BACKGROUND

19. It is the Government's established policy that public transport services should be run by the private sector in accordance with prudent commercial principles to achieve operating efficiency. However, ferry services for outlying islands are unique in that they are the only means of transport for outlying islands[6]. As there has been a lack of growth in patronage and given the escalating operating costs, the Government has been providing various measures to reduce the operating costs of the ferry services, and allow ferry operators to sublet the piers in order to increase non-fare box revenue to cross-subsidise their operations. The implementation of these measures aims to maintain the financial viability of the ferry services and alleviate the burden of fare increases on passengers. Details of these measures are at Enclosure 4.

Encl. 4

20. FC approved a commitment of $114,963,000 in November 2010 for providing further helping measures for the six major outlying island ferry routes during the licence period starting from 1 April/1 July 2011 for three years to alleviate the pressure of fare increases.

Transport and Housing Bureau
June 2013

6 Only Lantau Island is linked also by a road network, but its cross-district land-based public transport services are limited.

Principles and Rationale for the Review on Ferry Services for Outlying Islands in 2010

(a) Public transport services should be operated by the private sector on commercial principles

The 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 as this is the best way to provide efficient public transport services. However, taking into account that ferry services are the only means of transport for some of these outlying islands, we have to ensure that such essential services could be provided to the residents. Therefore, we have to provide special measures.

(b) Maintaining long-term financial viability and fare stability

In view of the uniqueness of ferry services, we have to ensure that these essential services are provided to the residents and the fares maintained at a stable level. However, the outlying island ferry services are faced with the chronic problems of a lack of growth in demand and highly volatile fuel costs which lead to the pressure of continued fare increase. Therefore, we need to provide further measures to tackle the chronic problems faced by the outlying island ferry services in order to ensure their long-term financial viability and maintain fare stability.

(c) Prudent use of public funds and the responsibility of individuals

In formulating the proposals, we have borne in mind the need for prudent use of public funds. We have struck a balance between the need to support essential services which otherwise would not be financially viable and the need to let those individuals who choose to live on the outlying islands shoulder the appropriate responsibility. Therefore, we proposed providing further assistance to the six major routes in 2010 in order to alleviate the burden of fare increases on passengers.

(d) Harbour planning considerations

We have all along been adopting measures to increase the non-fare box revenue of ferry operators. We are actively planning to construct one-and-a-half additional floors at each of Central Piers Nos. 4 to 6 for subletting by the ferry operators for commercial or retail purposes in order to generate more non-fare box revenue to cross-subsidise the operation of ferry services. However, construction of more additional floors or a change in the land use of the additional floors to office premises to generate more non-fare box revenue is against the planning principles for Central harbourfront and will not be acceptable to the public.

Details of the Special Helping Measures (SHMs)

At present, there are 13 outlying island ferry routes. They offer regular passenger services licensed under the Ferry Services Ordinance (Cap. 104). Of the 13 routes, six are major routes. Their average daily patronage was 45 300 in 2012, accounting for about 72% of the total average daily patronage of all outlying island ferry routes.

2. The Finance Committee approved in November 2010 a commitment of $114,963,000 for the implementation of the following package of SHMs to the six major ferry routes –

	SHMs	Total Commitment for the Current Three-year Licence Period $'000	Actual Amount Reimbursed in the First Operating Year $'000
(a)	reimbursing the operators of the ferry services concerned for the annual vessel survey fee and private mooring charge	27,042	8,447
(b)	reimbursing the pier electricity, water and cleansing charges		
(c)	reimbursing the balance of revenue foregone due to provision of elderly fare concessions after netting off the amount of pier rental reimbursement and vessel licence fee exemption under the established arrangement		
(d)	reimbursing the vessel maintenance cost	73,024	24,074
(e)	reimbursing the revenue foregone due to provision of child fare concessions	9,897	3,272
(f)	reimbursing the vessel insurance cost[1]	3,000	478
(g)	re-launching "Visiting Scheme to Outlying Islands"[2]	2,000	734
	Total	**114,963**	**37,005**

There are financial caps on these items, except (a), to control the total expenditure and avoid abuse.

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[1] Applicable to "Central – Peng Chau", "Central – Yung Shue Wan" and "Central – Sok Kwu Wan" routes only.

[2] The "Visiting Scheme to Outlying Islands" provides free ferry rides to eligible persons from schools, non-governmental organisations, community and local groups, etc. to encourage them to organise activities to the outlying islands served by the six ferry routes. The ferry operators may apply to the Government for the reimbursement of the revenue foregone. The applications for the scheme were closed in 2012 and most of the sum reserved for the scheme would be used up in 2012-13.

Enclosure 3 to FCR(2013-14)26

Operating Performance of the Six Ferry Routes

In the first operating year, a total of 80 complaints were received by the Transport Department (TD) on the services of the routes, i.e. a reduction of 10% compared with the previous operating year. According to the monitoring survey conducted by TD in February 2012, all six ferry routes were operated according to the Schedules of Service issued by TD, with appropriate additional sailings to cater for the upsurge of the demand subject to the availability of spare vessels.

2. Furthermore, according to a passenger opinion survey conducted recently by TD from January to February 2013, some 80% to 90% of the respondents considered the service adequacy and service reliability of the six ferry routes "very satisfied", "satisfied" or "fair". In respect of the overall performance of the routes, some 80% of the respondents considered it "very satisfied", "satisfied" or "fair" [Note].

3. TD's passenger opinion survey was conducted on board in the form of face-to-face questionnaire interviews. The respondents were selected by a pre-determined two-stage stratified sampling process with reference to the passenger profile of each route. A total of 1 960 questionnaires were successfully completed, resulting in an overall response rate of 62%.

[Note] The percentages of respondents considering the service adequacy, service reliability and overall performance "very satisfied", "satisfied" or "fair" by routes are as follows –

	Central – Cheung Chau	Inter -islands	Central – Mui Wo	Central – Peng Chau	Central – Yung Shue Wan	Central – Sok Kwu Wan
Service Adequacy	92%	89%	86%	87%	90%	68%
Service Reliability	89%	92%	95%	83%	95%	89%
Overall Performance	87%	87%	83%	76%	90%	77%

Enclosure 4 to FCR(2013-14)26

Existing Helping Measures for Licensed Ferry Services

The Government has been providing various helping measures to enhance the financial viability of ferry services, including –

(a) for all ferry routes –

   (i) taking over the responsibility of pier maintenance;

   (ii) waiving fuel duty;

   (iii) reimbursing pier rentals and exempting vessel licence fees for ferry services under the Elderly Concessionary Fares Scheme; and

   (iv) 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 increases;

(b) in addition, we have retrofitted Central Piers Nos. 4 and 6 with fire prevention facilities so that ferry operators can sublet pier premises for more diversified commercial and retail activities, benefitting the six major outlying island ferry routes. The works were completed in February 2010; and

(c) we are actively planning to construct one-and-a-half additional floors at Central Piers Nos. 4 to 6 so that ferry operators could use the floors for commercial or retail purpose to generate more non-fare box revenue for cross-subsidising the operation of ferry services.
