

Legislative Council Panel on Transport

Mid-term Review on

the Six Major Outlying Island Ferry Routes

Purpose

This paper reports the outcome of the Mid-term Review on a package of Special Helping Measures (“SHM”) which we have been providing to the six major outlying island ferry routes since 2011 (the “Mid-term Review”). It also recommends that enhanced SHM be provided in the next licence period from mid-2014 to mid-2017, having regard to the outcome of the Mid-term Review.

Background

2. 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. But, ferry services are unique in that they are the only means of transport for outlying islands¹. As there has been lack of growth in patronage of ferry services and 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 increase on passengers. Details are at **Annex A**.

3. The Government conducted a review on ferry services for outlying islands in 2010. In the course of the review and formulation of the proposals, our principles and concepts are (a) public transport services

¹ Only Lantau Island is also linked by a road network, but its cross-district land-based public transport services are limited.

should be operated by private sector on commercial principles; (b) the need to maintain long-term financial viability and fare stability; (c) the need for prudent use of public money and considerations that individuals should bear appropriate responsibility; and (d) harbourfront planning considerations. Details are at **Annex B**. In view of the above principles and concepts, we proposed providing SHM to 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 fare increase. With the SHM provided by the Government, the average fare increase of these six routes in this three-year licence period was about 10%. If SHM were not provided, the fare increase could be more than 20%.

4. When the Government proposed providing SHM to the operators of the six routes and consulted this Panel in 2010, the Government undertook to conduct a Mid-term Review to monitor the proper spending of public funds involved. The Panel was of the view that, if the operating costs were projected to be reduced, the Government should consider lowering the fare levels of the six routes. Subsequently, we sought the Legislative Council (“LegCo”) Finance Committee (“FC”)’s approval in November 2010 of a commitment of around \$115 million for implementation of a package of SHM to the six major outlying island ferry routes. Details are set out in **Annex C**.

Outcome of the Mid-term Review

(A) Financial Performance

5. We have examined the financial performance of the six ferry routes in the first operating year (i.e. from mid-2011 to mid-2012) of the current three-year licence period², with reference to the management and financial reports submitted by the two operators, New World First Ferry Services Limited (“NWFF”) and Hong Kong & Kowloon Ferry Holdings

² The Mid-term Review of the three-year licence period refers to 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 18-month period and the revenue was stable due to stagnant growth of patronage.

Ltd. (“HKK”)³. We have also projected the financial performance of the six ferry routes for the remaining two operating years in the current licence period.

6. In the first operating year, the six ferry routes received a total reimbursement of about \$37 million from the Government under the SHM. Details of the expenses are set out in Annex C. Assuming that the SHM would eventually amount to the ceiling of about \$115 million by the end of the current licence period, it is forecast that NWFF and HKK would only have a reasonable profit margin below 5% for the whole licence period. If the SHM were not provided for the current three-year licence period, there would be a loss margin of around negative 10% for both NWFF and HKK.

7. The analysis shows that the SHM 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 current licence period.

(B) Operational Performance

8. We have also assessed the operational performance of the six ferry routes by examining the complaint figures, passenger survey results and operational returns submitted by the operators. Findings show that the ferry services are satisfactory overall. Details are set out in Annex E.

Next Three-year Licence Period

(A) Continued Provision of SHM

9. The existing licences of the six ferry routes will expire in mid-2014⁴. Based on the financial data of the first operating year, it is

³ NWFF operates “Central – Cheung Chau”, “Inter-islands” and “Central – Mui Wo” routes whereas HKK’s three subsidiaries respectively operate “Central – Peng Chau”, “Central – Yung Shue Wan” and “Central – Sok Kwu Wan” routes.

⁴ The existing licence of “Central – Mui Wo” route will expire on 31 March 2014; the licences of the remaining five routes will expire on 30 June 2014.

anticipated that the existing provision of \$115 million SHM would be fully utilised at 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 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), if there is continued provision of SHM at the present level of \$115 million and if there is no change to the existing fare levels, NWFF and HKK would not be able to achieve breakeven for the next licence period from mid-2014 to mid-2017. There is therefore a case for continued provision of SHM and the financial caps should be adjusted upwards as appropriate due to rising costs.

10. Having regard to the principles and concepts as set out in paragraph 3 above, as well as the following data and considerations, the Government proposes adjusting upwards the caps for SHM in the next three-year licence period to \$191 million (details are at **Annex F**) –

- (a) the caps for expenses of reimbursable items in the next three-year licence period (the amount is projected based on the actual expenses of the reimbursable items in the first operating year of the current licence period);
- (b) the projected inflation rate; and
- (c) buffer provision to meet the increase of operating costs due to some factors which are difficult to project (for example, increase in statutory minimum wage on 1 May 2013 may have impact on the vessel maintenance cost and various pier charges).

11. Maintaining the SHM policy and providing upwards adjustment of financial caps would give better assurance of the financial viability of the six major outlying island ferry routes in the next three-year licence period from mid-2014 to mid-2017. As all the items under the SHM are reimbursement items subject to actual usage, the upwards adjustment would not lead to abuses as invoices would be carefully verified by the

(B) Commission of Inquiry into the Collision of Vessels near Lamma Island on 1 October 2012

12. The Commission of Inquiry's report was released on 30 April 2013. The Government will comprehensively and actively follow up the various recommendations set out in the report. We would consult the trade before taking a decision on how best to implement the recommendations. Once the decision is made, we would assess the cost implications on the operators of the six ferry routes and consider if new helping measures should be separately introduced.

(C) Renewal of Licences

13. 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 three 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 10-year aggregate period rule.

14. Both NWFF and HKK have indicated that, if the Government maintains the SHM policy and offers appropriate upwards adjustment of the financial caps for SHM, both of them are interested to apply for extension of their existing ferry service licences for three years. The Government considers that the option of extension of the existing licences to maintain the operation of the six ferry routes is more preferred. There are two reasons. Firstly, the services provided by the incumbent ferry operators are generally satisfactory (see paragraph 8 above). Secondly, due to the operating difficulties faced by the six ferry routes, even if we receive bids during the public tender exercise, we may receive bids with unsatisfactory conditions. Bidders may indeed request huge fare increase.

15. 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.

Way Forward

16. Subject to Members' views, we plan to seek funding approval from the LegCo FC in July 2013. We would proceed formally with the licence extension exercise after funding approval.

17. We are also actively pursuing the construction of additional floors at Central Piers Nos. 4, 5 and 6 to help the ferry operators generate non-fare box revenue for the six ferry routes. This would serve as long-term sustainable financial assistance to the six routes. The details are covered in another paper for discussion of this Panel on 24 May 2013.

Transport and Housing Bureau
Transport Department
May 2013

Existing Helping Measures for Licensed Ferries

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

- (a) for all ferry routes –
 - (i) taking over pier maintenance responsibility;
 - (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 increase;
- (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 was completed in February 2010; and
- (c) we are 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 activities to generate more non-fare box revenue for cross-subsidising the operation of ferry services. The Town Planning Board has approved the construction proposal on 3 May 2013. Subject to the funding approval of the LegCo FC, it is expected that the works will start in late 2013 with full completion in 2018.

**Principles and Concepts Adopted in the course of
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) Long-term financial viability and maintain fare stability

In view of the uniqueness of ferry services, we have to ensure that these essential services could be provided to the residents and the fares could be maintained at a stable level. However, the outlying island ferry services are faced with 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 to 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 shoulder the appropriate responsibility for choosing to live on the outlying islands. Therefore, we proposed providing further assistance to the six major routes in 2010 in order to alleviate the burden of fare increase on passengers.

(d) Harbour planning considerations

We have all along been providing measures (see **Annex A**) to enhance the non-fare box revenue of ferry operators. We are planning to construct one-and-a-half additional floors at each of Central Piers No. 4 to 6 for subletting by the ferry operators for commercial or retail activities 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 of land use of the additional floors to office development to enhance the non-fare box revenue that could be generated will be against the planning principles for Central harbourfront and not be acceptable to the public.

Annex C

Details of the SHM

At present, there are 13 outlying island ferry routes. They are regular passenger services licensed under the Ferry Services Ordinance (Cap. 104). Of them, 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 routes¹. A summary of all these routes including the six major ones and their patronage are at Annex D.

2. The LegCo FC approved in November 2010 a commitment of around \$115 million for implementation of the following package of SHM to the six major ferry routes –

	SHM	Total Commitment for the Current 3-year Licence Period	Actual Amount Reimbursed in the First Operating Year
(a)	reimbursing the operators of the concerned ferry services for the vessel survey fee and private mooring charge;	\$27M	\$8.4M
(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;	\$73M	\$24.1M
(e)	reimbursing the revenue foregone due to provision of child fare concessions;	\$10M	\$3.3M
(f)	reimbursing the vessel insurance cost (applicable to “Central – Peng Chau”, “Central – Yung Shue Wan” and “Central – Sok Kwu Wan” routes only); and	\$3M	\$0.4M

¹ Excluding the patronage of “Ma Wan – Tsuen Wan” licensed ferry service, which has ceased operation since 14 December 2012.

	SHM	Total Commitment for the Current 3-year Licence Period	Actual Amount Reimbursed in the First Operating Year
(g)	re-launching “Visiting Scheme to Outlying Islands” ² .	\$2M	\$0.7M
	Total	About \$115M	\$36.9M

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

² The Visiting Scheme to Outlying Islands provides free ferry rides to eligible persons who come from institutions such as schools, non-governmental organisations, community and local groups, to facilitate them to organise activities on the outlying islands served by the six ferry routes. The ferry operators are reimbursed with the revenue foregone from the Government. The applications for the scheme were closed in 2012 and the sum reserved for the scheme would be largely used up in 2012-13.

Annex D

Patronage of the 13 Outlying Island Ferry Routes in 2012

Outlying Island Ferry Routes ^{Note 1}	Average Daily Patronage in 2012
1. Central – Cheung Chau ^{Note 2}	23 610
2. Inter-islands (Peng Chau – Mui Wo – Chi Ma Wan – Cheung Chau) ^{Note 2}	915
3. Central – Mui Wo ^{Note 2}	5 531
4. Central – Peng Chau ^{Note 3}	5 618
5. Central – Yung Shue Wan ^{Note 3}	8 601
6. Central – Sok Kwu Wan ^{Note 3}	1 016
7. Hei Ling Chau – Peng Chau	437
8. Aberdeen – Yung Shue Wan via Pak Kok Tsuen	771
9. Aberdeen – Sok Kwu Wan via Mo Tat	553
10. Tuen Mun – Tung Chung – Sha Lo Wan – Tai O	698
11. Discovery Bay – Central	11 648
12. Discovery Bay – Mui Wo	252
13. Ma Wan – Central	3 376

Note:

1. Routes 1 to 6 are the six major outlying island ferry routes
2. Operated by New World First Ferry Services Limited
3. Operated by the subsidiaries of Hong Kong & Kowloon Ferry Holdings Ltd.

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 service of the routes, being 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 official Schedules of Service issued by TD, with appropriate additional sailings to cater for upsurge of 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, more than two-thirds of interviewed passengers 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, more than 75% of the interviewed passengers also considered it “very satisfied”, “satisfied” or “fair”¹.

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%.

¹ The percentages of respondents considering service adequacy, service reliability and overall performance “very satisfied”, “satisfied” or “fair” by routes are given 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%

Upward Adjustments of the Financial Caps on the SHM and its Assumptions

When adjusting the financial caps of the SHM in relation to the reimbursement for operating costs (i.e. items (b), (d) and (f) mentioned in paragraph 2 below), we adopt the actual expenses of the six ferry routes in the first operating year (i.e. mid-2011 to mid-2012) of the current three-year licence period, with concurrent reference to the estimated change of Composite Consumer Price Index in the subsequent years covering up to the first operating year of the next three-year licence period. As for the SHM which are related to revenue foregone (i.e. items (c) and (e) in paragraph 2 below), the financial caps are adjusted upward based on the actual revenue foregone of the six ferry routes in the first operating year of the current three-year licence period.

2. Details of the preliminary breakdown of the adjustments are tabulated as follows –

	SHM	Commitment
(a)	reimbursing the operators of the concerned ferry services for the vessel survey fee and private mooring charge;	\$1.6M
(b)	reimbursing the pier electricity, water and cleansing charges;	\$13.5M
(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;	\$19.0M
(d)	reimbursing the vessel maintenance cost;	\$95.7M
(e)	reimbursing the revenue foregone due to provision of child fare concessions;	\$23.5M
(f)	reimbursing the vessel insurance cost (applicable to “Central – Peng Chau”, “Central – Yung Shue Wan” and “Central – Sok Kwu Wan” routes only); and	\$3.4M

	SHM	Commitment
(g)	re-launching “Visiting Scheme to Outlying Islands”.	\$2.0M
	Estimated commitment	About \$159M
	Separate addition of a 20% buffer provision (buffer provision to meet the increase of operating costs due to some factors which are difficult to project (for example, increase in statutory minimum wage on 1 May 2013 may have impact on the vessel maintenance cost and various pier charges))	About \$191M