

Legislative Council Panel on Transport

MTR Fare Adjustment for 2018

(Information Paper)

This paper briefs Members on the MTR Corporation Limited (“MTRCL”) fare adjustment in 2018.

Importance on ensuring MTRCL’s financial sustainability

2. MTRCL is committed to providing the public with safe, reliable and highly efficient railway service. Having served the community for nearly 40 years, the MTR network has entered into a mature stage which requires significant investment in maintaining, upgrading and renewing our railway assets. To ensure the continued delivery of safe and reliable railway service, MTRCL spent more than \$6 billion in 2014 in maintaining, upgrading and renewing railway assets. The figure increased to more than \$8 billion in 2017, and is expected to continue to grow in 2018 and onwards.

3. Our efforts to renew railway assets cover a number of replacement projects involving substantial investment. MTRCL is now spending \$3.3 billion to replace the existing signaling systems on seven urban railway lines in phases; \$6 billion to purchase 93 new 8-car trains; and \$700 million to replace 30 and add 10 Light Rail vehicles. In addition, to respond to passenger needs and provide convenience, we have strived to improve station facilities, including the replacement of station chillers, retrofitting of additional lifts and escalators in some stations.

4. Sustaining high standard of on-time train service performance and continuous improvement in railway service requires stable financial position. Fare revenue is one of the major revenue sources. The Fare Adjustment Mechanism (“FAM”) provides a stable revenue source, enabling MTRCL to cope with the increasing operating expenses and costs of asset renewal, while at the same time ensuring that MTR fares are affordable to the public. Since the rail merger, from 2008 to 2017, the average year-on-year inflation rate in Hong Kong has been 3.2% and the average annual increase rate in Hong Kong Payroll Index has been 4.4%. Both percentages are well above the average annual increase rate of 2.5% in MTR fares over the same period.

Open and Objective FAM

5. The existing FAM has been adopted since the rail merger in 2007, superseding the fare autonomy MTRCL then enjoyed. The FAM adopts a direct-drive formula that adjusts fares in accordance with the economic figures released by the Government. The mechanism is open, objective and transparent.

6. During the legislative process of the rail merger, the FAM and its formula were extensively discussed in the Legislative Council and were approved at the shareholders' meeting of MTRCL after much deliberation and consideration as one of the approved conditions of the rail merger¹. The FAM forms part of the rail merger agreement between the Government and MTRCL, and is included in the Operating Agreement ("OA") signed between the two parties. It is legally binding.

Outcome of the Review on FAM in 2013 and 2017

7. Pursuant to the OA signed between the Government and MTRCL in August 2007, the FAM of MTRCL is to be reviewed every five years. The Government and MTRCL conducted the first review in 2012/13 and announced the review outcome in April 2013 (LegCo Paper No. THB(T)CR33/1017/99). The second review is originally planned for completion in 2018. Upon the Government's request in 2016, MTRCL agreed to advance the FAM review together with the Government one year earlier. The review outcome is applicable to the fare adjustment of the six-year period from 2017/18 to 2022/23.

8. In each review exercise, MTRCL has widely consulted relevant stakeholders, including Members of the Legislative Council and District Councils, passengers, shareholders and academics, in order to formulate a proposal that balances different views.

9. After completing the second FAM review in 2017, the Government and MTRCL jointly reported to the LegCo Panel on Transport in April 2017 (LegCo Paper No. THB(T)CR19/5591/00). The review outcome in 2017 is applicable to the fare adjustment of the six-year period from 2017/18 to 2022/23².

¹ As the Government is the single shareholder of the Kowloon-Canton Railway Corporation and the major shareholder of MTRCL, it did not participate in the voting.

² Next regular review of FAM should be completed in 2023.

10. Salient points of the FAM review outcome in 2017 applicable to the fare adjustment in 2018/19 include:

- (i) **Retain the existing direct-drive FAM formula and reduce the fare adjustment rate by 0.6 percentage point.** Annual Overall Fare Adjustment Rate of the six-year period from 2017/18 to 2022/23 would be calculated according to the following direct-drive formula:

Overall Fare Adjustment Rate

= (0.5 × change in Composite Consumer Price Index (“CCPI”) in December of the previous year)

+ (0.5 × change in Nominal Wage Index (Transportation Section) in December of the previous year)

– Productivity Factor (“PF”) (value set at 0%³ from 2017/18 to 2022/23)

- (ii) **Increase the provision for fare concessions under the “Profit Sharing Mechanism”.** This arrangement is made in response to public concern about the correlation between MTRCL’s profitability and the implementation of FAM. MTRCL has introduced a flat increase of \$25 million for every tier under the existing pre-determined tiered table of the “Profit Sharing Mechanism” and an increase of the upper limit for the profits counted from the original \$13 billion to \$15 billion. Furthermore, MTRCL has agreed to remove the previous cap that the amount returned to the passengers in any given year shall not be more than half of the total additional revenue

³ The Government and MTR agreed in the FAM review in 2013 to adopt the methodology to compute the PF value for the FAM formula. Productivity is measured as a ratio between output (i.e. income) and input (i.e. cost) in MTRCL’s transport operation, and shared between MTRCL and the passengers. According to the OA and the above methodology, in the event that the PF value is negative, it should be reset at “zero”, to avoid the situation where fare increase rate according to the FAM formula would be increased as a result of a negative PF value. However, at the request of the Government, the MTRCL has carefully examined its operation situation and agreed to, based on the fare adjustment outcome as per the FAM formula for the six years from 2017/18 to 2022/23, lower its fare increase by 0.6 percentage point each year to ensure that passengers can still benefit from a moderated fare to an extent which is consistent with the prevailing PF value of 0.6 percentage point.

generated by the corresponding fare increase.⁴ Details are set out in **Annex 1**;

- (iii) **Increase the provision for fare concessions under “Service Performance Arrangement”.** The maximum amount to be given back to passengers by MTRCL for each serious service disruption, defined as disruptions of 31 minutes or above caused by factors within MTRCL’s control, has been increased from \$15 million to \$25 million. Details are set out in **Annex 2**;
- (iv) **3% Rebate.** The total amount set aside under the “Profit Sharing Mechanism” and the “Service Performance Arrangement” will be used to fund a 3% fare discount per trip for passengers who travel on MTR journeys using Octopus. The scheme will last for at least six months every year to benefit more passengers, without any condition. If the proceeds are insufficient to cover the full period, MTRCL will top up the balance;
- (v) **Offer interchange discounts for Green Minibuses.** A new discount of \$0.3 for interchange between MTR and Green Minibus routes (over 500 routes in total) will be offered to Octopus users. Discounts on existing routes remain unchanged. The new interchange concession is expected to be implemented in the second quarter of 2018, and for 5 years, until June 2023;
- (vi) **Extend monthly pass schemes and related fare promotions.** Monthly Pass Extras and MTR City Saver have been extended to June 2023. MTRCL has also extended the validity of the MTR City Saver from 30 to 40 days to enable more flexible use for passengers;

⁴ MTRCL would, based on its underlying business profits each year, provide fare concessions so as to share the Corporation’s success with passengers and lessen the burden of fare increase on passengers. The underlying business profits include profits from all MTRCL businesses, i.e. profits from Hong Kong transport operations, Hong Kong station commercial business, Hong Kong property rental and management businesses, property developments, as well as profit from the Corporation’s overseas ventures. Profit arising from investment property revaluation is excluded.

- (vii) **Retain the affordability cap under FAM.** This would ensure that the fare increase pursuant to the FAM formula outcome should not be higher than the change in the Median Monthly Household Income (“MMHI”) for the corresponding period, in order to address the issue of public affordability; and
- (viii) **Continue to offer other fare concessions, including the “Early Bird Discount Promotion” Programme.** Apart from the existing fare concessions and promotional schemes (such as the Fare Concession for the Elderly, Fare Concession for Children, Student Travel Scheme, Day Pass and other interchange discounts), passengers can enjoy a 25% discount when exiting any of the 35 designated core urban stations between 7:15am to 8:15am from Mondays to Fridays (except Public Holidays). Details are set out in the map in **Annex 3**.

Overall Fare Adjustment Rate for 2018

11. MTR fare adjustment for 2018 will be implemented in accordance with the FAM as reviewed in 2017. According to the figures released by the Census and Statistics Department (“C&SD”) on 23 January 2018, the year-on-year increase of the CCPI for December 2017 over December 2016 is 1.7%. On 27 March 2018, C&SD published that the year-on-year increase of the Nominal Wage Index (Transportation Section) for December 2017 over December 2016 is 2.8%. Applying the FAM formula with the above two published figures, after adding the +1.49%⁵ rolled over from 2017/18 and **subtracting the special annual adjustment of 0.6% offered by MTRCL outside of the FAM formula**, the Overall Fare Adjustment Rate for MTR fares in 2018/19 comes to +3.14%. Detailed calculation is as follows:

⁵ Under the existing FAM arrangement, when the overall fare adjustment rate determined by the FAM formula falls within the range of -1.5% and +1.5%, the fare adjustment will be deferred and rolled over to the following year, i.e. the FAM rate will be added onto that for the next year for implementation. As the Overall Fare Adjustment Rate for MTR fares in 2017/18 is +1.49%, according to this arrangement, the said rate will be rolled over and added onto that for 2018/19 implementation.

Step 1: Basic calculation applying the FAM formula

Year-on-year % change in CCPI for December 2017	Year-on-year % change in Nominal Wage Index (Transportation Section) for December 2017	Productivity Factor value	Overall Fare Adjustment Rate based on FAM formula
1.7%	2.8%	0%	
$(0.5 \times 1.7\%) + (0.5 \times 2.8\%) - 0\% = +2.25\%$			

Step 2: After counting the rolled-over rate from 2017/18 and the special annual adjustment

Overall Fare Adjustment Rate based on FAM formula	Rolled-over Rate from 2017/18	Special Annual Adjustment committed by MTRCL in the FAM review in 2017	Overall Fare Adjustment Rate for 2018/19
$(+2.25\%) + (+1.49\%) - \mathbf{0.6\%} = \mathbf{+3.14\%}$			

12. As regards public affordability, the Overall Fare Adjustment rate of +3.14% is significantly lower than the 11.89% increase in MMHI over the fourth quarters of two years in 2016 and 2017.

13. As per the OA's requirement, the actual changes to individual fares will be announced by MTRCL in due course before implementation of new fares in June 2018.

MTRCL continues to offer fare concessions for passengers

14. According to the FAM, MTRCL will offer a total fare concessions of \$222.5 million, including \$200 million from the "Profit Sharing Mechanism" and \$22.5 million from the "Service Performance Arrangement", to passengers. Upon the implementation of new fares, MTRCL will provide the "3% Rebate" to Octopus users for at least six

months. MTRCL expects that there will unlikely be any actual fare increase for Octopus users in 2018. MTRCL will also continue to offer MTR City Saver and Monthly Pass Extras.

15. MTRCL will continue to offer a wide range of fare concessions and promotional schemes every year (such as the Fare Concession for the Elderly, Fare Concession for Children, Student Travel Scheme, Day Pass and other interchange discounts) to benefit and encourage different sectors of the community including the elderly, children, eligible students and persons with disabilities to use the railways. These on-going fare promotions amounted to about \$2.6 billion in 2017/18. Details of the existing fare concessions offered by MTRCL are at **Annex 3**.

16. Details of other fare concessions will be announced in due course.

Conclusion

17. Members are invited to note this paper.

MTR Corporation Limited
May 2018

Existing arrangement of “Profit Sharing Mechanism”

“Profit Sharing Mechanism”

MTRCL will set aside the amount to be shared with passengers each year under different profit levels according to a pre-determined tiered table. Details of the pre-determined tiered table are as follows:

<u>Underlying Business Profit in previous Year</u>	<u>Amount for Fare Concessions</u>
Below \$5 billion	0
\$5 billion to <\$6 billion	\$75 million
\$6 billion to <\$7 billion	\$100 million
\$7 billion to <\$8 billion	\$125 million
\$8 billion to <\$9 billion	\$150 million
\$9 billion to <\$10 billion	\$175 million
\$10 billion to <\$11 billion	\$200 million
\$11 billion to <\$12 billion	\$225 million
\$12 billion to <\$13 billion	\$250 million
\$13 billion to <\$14 billion	\$275 million
\$14 billion to <\$15 billion	\$300 million
≥\$15 billion	\$325 million

Note: The underlying business profits include profits from all MTRCL businesses, i.e. profits from Hong Kong transport operations, Hong Kong station commercial business, Hong Kong property rental and management businesses, property developments, as well as profit from the Corporation’s overseas ventures. Profit arising from investment property revaluation is excluded.

**Current calculation method of
“Service Performance Arrangement”**

“Service Performance Arrangement” (SPA)

The amount to be set aside for fare concession for each serious service disruption under the SPA is as follows:

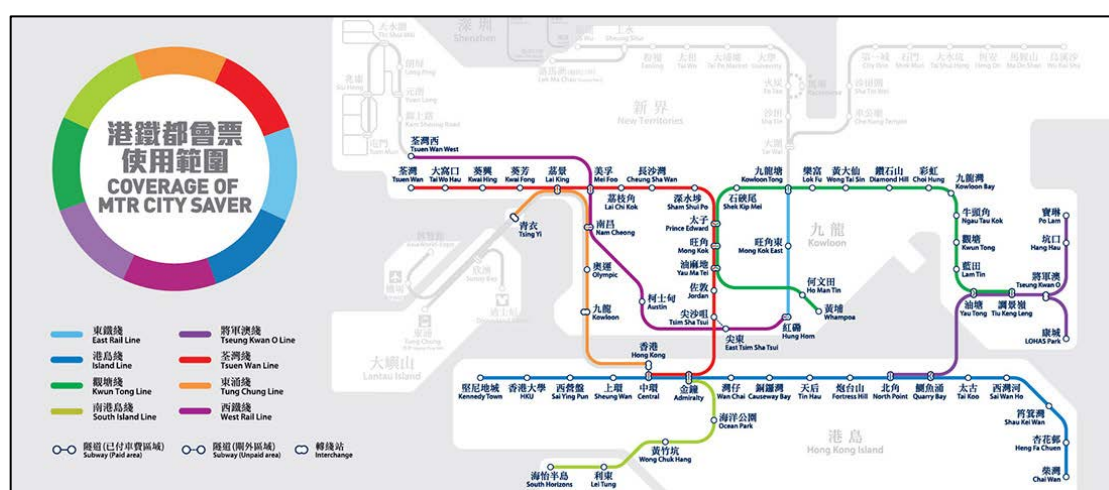
<u>Train Service Disruption</u>	<u>Amount per Incident</u>
Equal to or more than 31 minutes but less than or equal to one hour	\$1 million
More than one hour but less than or equal to two hours	\$2 million
More than two hours but less than or equal to three hours	\$3 million
More than three hours but less than or equal to four hours	\$5 million
Each additional hour (or part thereof) exceeding four hours	\$2.5 million
Maximum amount per incident	\$25 million (i.e. covering a disruption of twelve hours or more)

Note: Service disruption is defined as disruptions and suspensions caused by equipment failure or human factor within MTRCL’s control. “Exemption Events” (i.e. events which are outside the control of MTRCL such as passengers’ behaviours and bad weather) are excluded under the SPA.

Existing fare concessions offered by MTRCL

“MTR City Saver”

In June 2014, MTRCL introduced a new “MTR City Saver” to benefit medium- and long-distance frequent travellers commuting within the urban area, i.e. essentially the zone not covered by the existing “Monthly Pass Extras”. Holders of “MTR City Saver” tickets are entitled to 40 rides within 40 days between the designated stations in the urban area. The coverage of “MTR City Saver” is set out below.



“Monthly Pass Extras”

After purchasing “Monthly Pass Extra”, passengers are entitled to unlimited rides between the specified stations within a month. In addition, passengers can enjoy a 25% discount for connecting domestic journeys beyond the specified stations. Current prices are set out below:

Pass	Current Price
Tung Chung – Hong Kong Monthly Pass Extra	\$620
Tung Chung – Nam Cheong Monthly Pass Extra	\$395
Sheung Shui – East Tsim Sha Tsui Monthly Pass Extra	\$475
Tuen Mun – Nam Cheong Monthly Pass Extra	\$500
Tuen Mun – Hung Hom Monthly Pass Extra	\$585

Day Pass promotion

The promotion period for Tuen Mun – Nam Cheong Day Pass is up to 30 June 2018. Current price of the Day Pass is \$27.

“Early Bird Discount Promotion” Programme

To address the relatively high train loading situation during the morning peak period, MTRCL launched the “Early Bird Discount Promotion” Trial Programme in 2014. Commuters holding Adult Octopus can enjoy a 25% fare discount when they exit from any of the 35 core urban stations (set out below) between 7:15 a.m. and 8:15 a.m. from Mondays to Fridays (except Public Holidays). Existing “Early Bird Discount Promotion” Programme will last until 31 May 2018.



“3% Rebate” promotion

MTRCL will set aside a total of \$222.5 million for the “3% Rebate” promotion under the “Profit Sharing Mechanism” and “Service Performance Arrangement” in 2018. Details are set out below:

(i) “Profit Sharing Mechanism”

Since 2013, MTRCL has been sharing its yearly underlying business profit with passengers by way of giving fare concessions. For this purpose, a pre-determined tiered table is used to decide on the amount to be shared with passengers under different profit levels with such amount being put into a fare concession account. According to the tiered table, an amount of \$200 million will be shared with passengers in 2018/19 through the “3% Rebate” promotion.

(ii) “Service Performance Arrangement”

According to the outcome of the FAM review in 2017, the “Service Performance Arrangement” has been enhanced whereby MTRCL will set aside an amount, ranging from \$1 million to \$25 million, for each serious service disruption, defined as disruptions of 31 minutes or above which are within the control of the MTRCL. There were 10 such disruptions in 2017. Passengers will receive additional fare concessions of \$22.5 million through the “3% Rebate” promotion.

(iii) The MTRCL is also committed to topping up where necessary the concession amount set aside for the 3% rebate to ensure it would last for at least six months.

Apart from the above promotion, MTRCL continues to offer a wide range of fare concessions and promotional schemes to benefit and encourage different sectors of the community to ride on MTR. Details are set out below:

Promotion	Details
Student Travel Scheme	<ul style="list-style-type: none">• MTRCL is the major public transport operator in Hong Kong providing full-year fare concessions for every trip to eligible local students.• Eligible full-time students aged between 12 and 25 can enjoy about half-fare concessions with their Personalised Octopus encoded with Student Status (not applicable on journeys to/from Lo Wu and Lok Ma Chau Stations, East Rail Line First Class, MTR Feeder Bus and Airport Express).

Promotion	Details
	<ul style="list-style-type: none"> The average daily number of passenger trips in the MTR network enjoying the student fare concession is about 463,000.
Fare Concession for the Elderly#	<ul style="list-style-type: none"> Elderly persons aged 65 or above can enjoy about half-fare concessions using Elderly Octopus, Personalised Octopus or Concessionary Single Journey Tickets. MTRCL funds the difference between half-fare and \$2 for Elderly Octopus users travelling in the domestic network on Wednesdays, Saturdays and public holidays (except Sundays) while the other days are funded by Government. In addition, the \$2 fare concession to and from Racecourse Station enjoyed by Elderly Octopus holders is funded by MTRCL. The average daily number of passenger trips in the MTR network enjoying the elderly fare concession is about 480,000.
Fare Concession for Children	<ul style="list-style-type: none"> Children aged 3 to 11 can enjoy about half-fare concessions using Child Octopus or Concessionary Single Journey Tickets. The average daily number of passenger trips in the MTR network enjoying the child fare concession is about 185,000.
Fare Concession for Persons with Disabilities#	<ul style="list-style-type: none"> Eligible persons with disabilities are defined as recipients aged 64 or below under the Comprehensive Social Security Assistance Scheme with 100% disability or recipients of Disability Allowance. MTRCL funds with its own resources half-fare concessions for Persons with Disabilities while the Government pays for the difference between half fare

Promotion	Details
	<p>and \$2.</p> <ul style="list-style-type: none"> The average daily number of passenger trips in the MTR network enjoying the fare concession for persons with disabilities is about 67,000.
Fare Savers	<ul style="list-style-type: none"> Currently, there are 37 fare savers. By waving Adult Octopus over the machines, passengers can enjoy \$2 discount for their next train trip at designated MTR stations.
Light Rail Personalised Octopus Frequent User Bonus Scheme	<ul style="list-style-type: none"> Adults, children or senior citizens who travel on Light Rail using a Personalised Octopus can accumulate bonus points for discounted journey on Light Rail.
Interchange between West Rail Line and Light Rail/MTR Bus	<ul style="list-style-type: none"> Passengers using the same Octopus to transfer between designated West Rail Line stations and designated Light Rail stops/MTR Bus routes within a specified time period can enjoy free rides on Light Rail (applicable on Light Rail journeys with Adult and Concession Octopus fares lower than or equal to \$4.8 and \$2.4 respectively) or MTR Bus routes.
Interchange between Light Rail and MTR Bus	<ul style="list-style-type: none"> Passengers using the same Octopus to transfer between Light Rail and designated MTR Bus routes within a specified time period can enjoy the MTR Bus ride for free.
Interchange between MTR and MTR Feeder Bus	<ul style="list-style-type: none"> Passengers using the same Octopus to transfer between MTR and MTR Feeder Bus routes at designated MTR stations within a specified time period can enjoy interchange discounts equal to \$4.0, or the MTR fare, whichever is lower.
Interchange discount between MTR and New Lantao Bus	<ul style="list-style-type: none"> Adult passengers using the same Octopus to transfer between MTR and designated New Lantao Bus routes at Tung Chung Station within a specified time period can enjoy an interchange discount of \$1.0.

Promotion	Details
Interchange discount with Green Minibuses	<ul style="list-style-type: none"> • Passengers using the same Octopus to transfer between MTR and designated Green Minibus routes at designated MTR stations within a specified time period can enjoy interchange discounts at \$0.3 or above, depending on the individual route.

Under the Public Transport Fare Concession Scheme for the Elderly and Eligible Persons with Disabilities implemented by the Government since 28 June 2012, Elderly and eligible Persons with Disabilities enjoy the concessionary fare of \$2 per trip for MTR domestic service.