New Approach to Ferries

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Introduction

Following the May 9 announcement by the Ministry of Transportation and Infrastructure of a “new course for ferries”, I managed to arrange three hour-long telephone meetings for the Ferry Advisory Committee Chairs with the Assistant Deputy Minister responsible, with the President and CFO of BC Ferries and with the BC Ferry Commissioner and Deputy Commissioner. These provided some insight into how this new approach might play out and also identified a number of questions. This is the most significant action on ferries since the Coastal Ferry Act came into being in 2003.

Summary

The Province’s announcement has four components:

- Amendments to the Coastal Ferry Act, including with respect to considerations that lead to the determination of price caps.
- An additional $79.5 million in provincial government contributions over the next four years.
- An expected $30 million dollars in savings resulting from reduced service levels
- The development of strategies to implement a new vision for coastal ferry service in consultation with communities
- An expected $15 million dollars in reduced costs from operational efficiencies.

These measures are expected to reduce the upward pressure on fares.

Background

The following lead up to this announcement:

- In March 2011, Hon Blair Lekstrom was appointed Minister of Transportation and in meetings not long thereafter with the Ferry Advisory Committee Chairs and UBCM representatives heard that escalating ferry fares are having significant impacts on communities.
- In May 2011, Gord Macatee was appointed BC Ferry Commissioner and in reviewing public comments on the Performance Term Three preliminary price caps (4.15% per annum on the majors and 8.23% per annum on the non-majors) set by his predecessor learnt of the significant public concern about fares.
- In May 2011, the Commissioner wrote to the Minister proposing a review of the Coastal Ferry Act.
- In June 2011, the Province enacted Bill 14, requiring the Commissioner to review the Coastal Ferry Act, postponing final decisions on price caps for Performance Term 3 for a year (until September 2012) and establishing price caps for the first year of the term (2012-13) at 4.15%.
- Summer to winter 2001, the Commissioners participated in 40 meetings in coastal communities to receive public input, reviewed the regulatory framework for other ferry systems and evaluated options to balance the interests of ferry users and tax payers with the sustainability of the operator
In January 2012, the Commissioner provided the Minister with his report containing 31 recommendations.

In May 2012, the Province announced measures intended to implement the recommendations.

**Amendments to the Coastal Ferry Act**

*Bill 47*, which amends the *Coastal Ferry Act*, has been passed by the BC Legislature. Key provisions include changes that:

- Remove requirement for movement towards “user pay”
- Replace the priority of “the financial stability of the ferry operator” with balancing the interests of ferry users, the interests of taxpayers and the financial stability of the operator
- Remove the prohibition against cross-subsidization between route groups
- Add the principle of requiring innovation
- Replace the requirement for establishing a specified return on equity with allowing for the ferry operator to meet debt obligations and maintain access to reasonable borrowing rates
- Require approval of major capital expenditures by the Commissioner and approval of the capital plan
- Empower the Commissioner to conduct a performance review of BC Ferries and to require BC Ferries to prepare plans, review policies and engage in public consultation
- Enable the Commissioner to require permanent reduction of service on a designated route

**Additional provincial government contributions**

The Province provides “Ferry Transportation Fees” to BC Ferries for providing the level of service specified in the Coastal Ferry Services Contract. The transportation fees for the minor routes and Route 3 have remained unchanged since 2003 at $91.82 million. Additional contributions for northern routes have been provided to help offset vessel acquisition and fuel costs ($33.78 million in 2010-11).

The Province will be providing the following additional funds over the next few years:

- $25m in 2011-12
- $21.5m in 2012-13
- $10.5m in 2013-14
- $11m in 2014-15
- $11.5m in 2015-16

**Savings from Service Reductions**

A target of $30m has been set for savings from service adjustments over the next four years. As the bulk of the costs are on the major routes, the bulk of the savings can expected to be achieved through cutting sailings on those routes (such as proposed by BC Ferries this past winter). Sailings on other routes that are significantly under-utilized – including late evening sailings – will also be targeted for consideration.

The Ministry will establish principles and rationale to guide the identification and achievement of potential short-term saving (taking into account the characteristics of each route) in order to target where cuts might be made to contribute to the goal of $30m in savings across the system.
The Ministry is preparing a Request for Proposal for a consultant who will design and plan the consultation process. Input from the Ferry Advisory Committee Chairs will be sought when designing and planning is carried out. It is anticipated that information on specific proposals for sailing cuts and expected resulting savings on each route will be made available over the summer, with community consultation meetings happening in the fall. Ferry Advisory Committees and local governments will be treated as key stakeholders. People outside of the directly-affected communities will be able to provide comments on-line.

**Strategies to Support a New Vision**

The Province will also be facilitating community consultations to identify strategies to support a vision for coastal ferry service. The government’s vision is “to connect coastal communities in an affordable, efficient and sustainable manner”. Anything could be put on the table as potential alternatives, including bridges or passenger ferries. Again, the Ferry Advisory Committee Chairs are expected to be consulted to help ensure this process works effectively for our communities.

The Province will also be facilitating community consultations to identify strategies to support a vision for coastal ferry service. The broad vision statement is as follows: “The government's vision is to connect coastal communities in an affordable, efficient and sustainable manner”. The phrase “connecting coastal communities” was deliberately chosen rather than referring specifically to ferries to allow for integrated transportation planning that can include other modes of transportation. Bridges and passenger only service could be considered in particular situations where these might provide a viable option. (Bridges have not been on the table up to now because previous assessments have indicated they would not be cost effective. The Ministry is open to the possibility that changed circumstances may generate renewed interest in assessing bridges as an option in the very limited number of situations where they might be viable).

The Ministry will develop principles to guide discussion of short term and long term strategies to support the vision. Again, the Ferry Advisory Committee Chairs are expected to be consulted to help ensure this process works effectively for our communities. Consultation will happen in two stages. The first will be the consultation described above to focus on short term measures to achieve the $30m in savings from service adjustments in PT3 and to introduce the framework for long-term planning discussions. The second will focus on long term strategies to support the vision. (Those routes with pending decisions on vessel acquisition, such as the Northern Sunshine Coast and Route 9 will be priorities for consultation and the two stages of the process will likely be rolled into one to look at both short term and long term issues.)

**Cost Reductions from Operational Efficiencies**

BC Ferries is expected to implement $15m in efficiencies over the next four years. Measures cited as potentials for generating savings include increasing the interoperability of vessels between routes and utilizing innovations such as Liquefied Natural Gas and cable ferries.

**Reducing Upward Pressure on Fares**

Since 2003, ferry fares have increased at several times the rate of inflation (CPI). The provisional price cap set for Performance Term Three would allow annual increases of 4.15% per annum on the majors and 8.23% per annum on the non-majors in April 2012, 2013, 2014 and 2015. (As noted above, Bill 47 capped the 2012 increase for the non-majors at 4.15% for April 2012.)

One of the Commissioner’s recommendations in his January 2012 report was “that the Province should consider an increase in subsidies together with other initiatives to hold price cap increases to the rate of inflation for the balance of PT3.”
While the announced measures are expected to reduce the upward pressure on fares, it is likely that increases will still be well above the rate of inflation. Both the Ministry and BC Ferries anticipate annual increases of around 4% (likely about twice the rate of inflation) for the remainder of PT3 resulting from the proposed package of measures, with the caveat that the actual determination will be made by the Commissioner taking into account the full spectrum of considerations, including traffic projections. The longer term impacts are hard to assess because of the variables involved, but a full suite of measures could bring future fare increases closer to the rate of inflation.

**Analysis**

The following are personal comments based on what I have heard from the Ministry, BC Ferries and the Commissioner and in discussions by the Ferry Advisory Committee Chairs:

- **Legislative changes**

Some of the changes (such as removal of the requirements for moving towards user pay, for no-cross-subsidization and for a specified return on equity) are ones the FAC Chairs have wanted to see addressed for several years. However, they will not in and of themselves make a huge impact on fares. The degree of “user pay” is largely dependent upon how much the Province chooses to contribute.

Cross-subsidization does not open floods of money from the majors to the minors because the majors are losing traffic and have large debt repayments to cover; however, there will be a unified price cap which will reduce the cap on the non-majors and increase it somewhat on the majors once everything else has been taken into account.

The elimination of a specified return on equity will have only a modest impact in the short term because BC Ferries has not been achieving the specified return in recent years and there still has to be provision for debt repayment and achieving reasonable borrowing rates; the Commissioner believes this could have a significant impact on fares in the longer term.

Increased oversight of BC Ferries by the Commissioner may help identify and eliminate excessive costs, (though the low-hanging fruit has likely already been picked) and may help ensure good planning and consultation.

- **Provincial contributions**

The Commissioner identified an annual shortfall of over $50m required to keep fare increases at the rate of inflation. The Province’s additional contribution of $79.5m over four years falls far short of this. The bulk of the money - $46.5m in the first two years – is intended to help make up for the fact that BC Ferries will not be getting a legislated RoE. This will contribute somewhat to reducing the upward pressure on fares as the Preliminary Price Cap was based on allowing for a 12.73% RoE.

While there is disappointment that the level of additional provincial support is inadequate to significantly slow the increases in fares, the Commissioner stated he was surprised that the Minister managed to secure this much money given the fiscal context and the competing demands for tax dollars.

The opposition continues to articulate that the solution is to return ferry operations to being part of the highways system but have not spelled out how this would in and of itself address the challenges, including ongoing funding (which was previously inadequate when coastal ferries were directly operated by the Ministry, resulting in the present system made up of aged vessels, terminals and IT).
- **Service adjustments**

It is important to note that reductions in sailings will not automatically translate into worthwhile savings. The main cost areas in order of significance are labour, maintenance/capital and fuel. Labour costs can mainly be reduced by eliminating overtime or cutting shifts. Cutting out sailings in the middle of the day when there is no provision for split shifts will not reduce labour costs. Cutting sailings will have limited impact on maintenance and capital costs. On some routes, fuel is a very minor component of costs.

It is also important to consider round trips when looking at capacity utilization because, as we all know, there are times of the day when vessels are close to full going in one direction and close to empty going the other. On some routes, home porting affects capacity utilization at the beginning and end of the day.

- **Strategies to implement a vision**

A key issue is whether, in what circumstances and how savings resulting from a community being willing to accept less service might directly benefit as a result of savings being applied to reducing fares on that route. The Ministry’s perspective is that now the barrier to cross-subsidization has been removed, the benefits from savings should be applied system-wide. The Ministry agrees that it is very unlikely local governments will be keen to participate in using tax dollars to buy down fares. However, this option is identified to reflect its articulation by the Commissioner as a possible alternative rather than as an expected avenue for action. There will be discussions with local governments about this potential option.

- **Operational efficiencies**

The two potential innovations identified for operational efficiencies are conversion to LNG and cable ferries.

Although it has been suggested that the use of LNG could generate savings of up to $30m, the Commissioner notes that it would take five years to pay down the capital costs of conversion. BC Ferries states that it would make little sense to convert the several vessels that are close to the end of their lives. LNG makes most sense where it can be piped to a terminal.

Route 22 (Buckley Bay – Denman Island) is the only route identified as being feasible for a cable ferry operation. The high level feasibility work indicates significant potential savings. However, engineering analysis is now being carried out by a contractor work and may identify different outcomes.

- **Reducing the upward pressure on fares**

As noted above, it is anticipated that these measures could result in annual fare increases of around 4%, which is about half the rate of increase identified in the Commission’s preliminary price cap for the next four years. The outcome is significantly dependent upon traffic, among other factors. The preliminary price cap was based on flat traffic levels, but traffic has been steadily declining. The final price cap will be determined in September 2012 and it will be interesting to see what traffic forecasts are used in making the decision.

[While the Ferry Advisory Committee Chairs see traffic declines linked to increasing fares based upon our own analysis and hearing directly from ferry users, the Province and BC Ferries point to other factors. Traffic on the free inland ferries has also seen significant declines and fares are obviously not a factor there. Declining Gas Tax receipts are impacting transit funding. Tracked indicators show a general decline in tourism.]

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