



Report 09.742
Date 17 November 2009
File T/02/11/01

Committee Transport and Access
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NZTA Farebox Recovery Policy

1. Purpose

To consider a submission on the NZ Transport Agency draft farebox recovery and fare review policies.

2. Significance of the decision

The matters for decision in this report **do not** trigger the significance policy of the Council or otherwise trigger section 76(3)(b) of the Local Government Act 2002.

3. Background

3.1 The draft NZTA farebox recovery policy

The New Zealand Transport Agency (NZTA) has produced a draft “Farebox Recovery Policy” which proposes that each region have a minimum (and generally higher than current) recovery target. NZTA has produced a discussion document on the proposed policy, and is seeking submissions by 30 November 2009.

3.1.1 What is farebox recovery?

Farebox recovery, which is often also called cost recovery or revenue recovery, is the percentage of the costs of providing a service that are covered by passenger revenue. Thus, for example, if a service costs \$100 to provide, and generates fares of \$40, then the farebox recovery level is 40%. The remaining \$60 needed to pay for the service is provided by way of subsidy, with generally half of the subsidy provided by NZTA, and half by ratepayers (in this example, NZTA and ratepayers would contribute \$30 each).

The farebox recovery percentage can be raised by either increasing passenger revenue (by either attracting more passengers or raising fares), or lowering costs (through either efficiencies or reducing services with low patronage).

A high farebox recovery means lower subsidy from NZTA and ratepayers. For the above example, if fares covered 50% of costs, then the subsidy from both NZTA and ratepayers reduces from \$30 to \$25.

3.1.2 Current farebox recovery rates

The farebox recovery levels (as calculated by NZTA) for some of the regions in NZ are set out below:

Region	2004/05	2005/06	2006/07	2007/08
Auckland	47.5%	40.9%	41.2%	43.6%
Waikato	34.3%	30.3%	25.8%	29.5%
Bay of Plenty	28.7%	28.9%	26.8%	25.9%
Manawatu-Wanganui	36.8%	27.8%	27.2%	22.7%
Wellington	53.2%	50.3%	53.0%	51.5%
Canterbury	46.2%	43.5%	40.3%	41.1%
Otago	52.4%	45.6%	44.2%	40.5%
Southland	11.6%	9.6%	10.0%	8.6%
National	48.3%	43.2%	44.8%	44.4%

The calculations include costs and revenues from commercial services, but do not include rail capital costs, council administration costs, or network costs (such as those associated with real-time, integrated ticketing, call centres etc).

As can be seen, the Wellington region has the highest level of farebox recovery of all the regions. It is also apparent that while the Wellington level is relatively constant, the overall trend for most regions (and NZ as a whole) is down. The national recovery level is 44.4%, and has been declining, dropping from 50% in 2000/01. NZTA has forecast that the nationwide level will drop even further in the coming years. A decline in farebox recovery means that extra NZTA funding (and ratepayer funding) is required to support the same level of service.

The differing recovery levels throughout NZ mean that each region is receiving, in relation to total costs, a different subsidy percentage from NZTA. For example, Wellington, with a farebox recovery of 51.5%, receives approximately 24.25% of its costs from NZTA subsidy (the ratepayers pay the other 24.25%). Auckland receives 28.2% of its costs from NZTA, and Southland 45.7%. Thus Wellington is receiving a lower percentage NZTA subsidy than all other regions.

3.1.3 Why NZTA has introduced this policy

At the moment NZTA has no farebox recovery policy. The NZTA discussion document states that NZTA has decided to introduce a policy because NZTA *“has a strong interest in encouraging improvements in operational efficiency and setting expectations around appropriate levels of subsidy”*. [Although just how efficiency is improved by an increase in farebox recovery is not explained - a service can be “efficient” yet still have a low farebox recovery. Nor is any explanation provided as to what “appropriate levels of subsidy” are. There is mention in the consultation document that research is planned to be undertaken to *“establish optimal fare and subsidy settings for public transport systems in NZ”*, but this research is to occur after the policy is put in place].

Despite the efficiency and appropriateness arguments given as the reason for the policy, the real (and valid) reason seems to be that NZTA is concerned at the lowering of the national farebox recovery rate, and the funding implications that that has for NZTA i.e. it will cost NZTA more in the future to support the same level of service. It is clear from the discussion document that the intention of the policy is to reduce future NZTA subsidy levels in relative terms by raising farebox recovery.

3.2 GW fare recovery policy

This Council currently has its own farebox equivalent recovery policy - the Council Revenue and Financing Policy (which forms part of the LTCCP) has a policy that 45-50% of the costs¹ of providing public transport should be covered by fares (calculated on a network wide basis). This policy is pivotal in the Council fare level decision making process.

The latest calculations undertaken by GW indicate that this council is within the 45-50% target range, and this is similar to the NZTA figures (although the NZTA figures are calculated on a slightly different basis).

3.3 Draft NZTA fare review policy

The NZTA consultation document also contains a draft policy regarding fare structure and fare level reviews. The draft policy proposes that councils should review their fare levels every year, and their fare structures (i.e. the overall structure such as zones, multi-trip discounts, concessions etc) every three years. A process for the review of fare structures is proposed.

4. The NZTA draft farebox recovery policy

The draft NZTA policy is at **Attachment 1**.

According to the policy, it is based upon the following objectives and principles:

¹ The GW policy includes debt servicing costs, but not administration or network costs. It excludes commercial services.

Objectives

- *Improve efficiency and effectiveness of PT; and*
- *Ensure the costs and benefits of the services are fairly apportioned between user and non-users.*

Principles

- *The contributions users and non-users make should reflect the benefits they receive; and*
- *The costs should be shared fairly.*

Councils are required to set farebox recovery “targets”. NZTA has offered two options for this:

- **Option one**, where councils set their own farebox recovery targets, based on the NZTA objectives and principles; and
- **Option two**, where Auckland, Wellington and Canterbury have a compulsory target of 50% (unless they can convince NZTA that another target is appropriate), and the other regions are able to set their own targets (but still based on the NZTA objectives and principles, with NZTA able to set an alternative target).

Both options require consultation with (and in essence the approval of) NZTA.

NZTA propose a formula for calculating the recovery ratios. The general principle is to:

- include all services (commercial as well as contracted);
- exclude administration costs; and
- include capital costs.

NZTA has recognised that obtaining cost information, particularly for commercial services, may be difficult, and is therefore proposing to use operator income (fare revenue and any subsidy payments) as a proxy for costs.

With regard to capital costs, these costs for buses are relatively easily included because they are in effect already included in council contracts (although not for the trolley bus overhead). Rail capital costs however present more of a difficulty but the consultation document indicates that work is currently being undertaken on a method to calculate rail costs, and that these costs will eventually be included in the formula. [Note that rail capital costs are currently not included in the NZTA calculation of farebox recovery; if rail capital costs are to be included, this will have a major negative impact on the Wellington farebox recovery ratio].

Councils will be required to achieve the farebox target within three years (tied to the three year NZTA funding cycle), and council policies must set out a transition arrangement to achieve the target. The policy is silent on what happens if the targets are not achieved (although the discussion document does state that NZTA funding will be “*at risk*” if the region’s policy is not implemented).

The NZTA policy sets out an “*intervention hierarchy*” which is to be applied when considering how to reach the target. The three components of this hierarchy are:

- Improving operational efficiency
- Improving ridership productivity
- Increasing fare prices (to be done incrementally).

It is clear from the discussion document that NZTA expect the council targets to be higher than current recovery levels, although no indication of the desired levels (other than the 50% target for Auckland, Wellington, and Canterbury) is given.

The document proposes that each region formalise its targets (and a justification thereof) through inclusion in Regional Public Transport Plans.

Councils will be required to conduct:

- annual reviews of fare levels, discounts and ticket types; and
- a review of fare structures at least every three years.

The review process is discussed further below.

Councils will be required to report on an annual basis to NZTA:

- The aggregate farebox recovery across the region’s network
- The aggregate farebox recovery for each “centre” (“centre” is not defined)
- Farebox recovery by mode
- Farebox recovery and services where the ratio is falling below 25% (“service” is defined in the policy as a service operating on a distinct route).

5. Comment

5.1 Comment on the draft policy

Some general comments on the draft policy are set out below, followed by some more specific comments:

5.1.1 General

This policy is clearly an attempt by NZTA to restrict the growth in its future subsidy payments by increasing the contribution of the passengers. By its own admission, NZTA has no evidence that the current passenger contribution levels are not currently appropriate – it simply notes that the passenger contribution towards total costs is declining and thus the NZTA contribution is increasing. NZTA wants to restrict the growth in its contribution and it proposes to do this by increasing passenger contributions.

NZTA states that improvements to efficiency and effectiveness are the main objectives of the proposed policy, and that achieving these will result in improved farebox recoveries and thus deliver the results NZTA wants. But this ignores the fact that regions are constantly seeking to improve efficiency and patronage. And operators are also constantly seeking to improve efficiency to improve their profitability.

And patronage increases in current times result from either new services (which are difficult to introduce because of current funding conditions) or external factors (such as population growth, increases in the price of petrol, and new housing developments).

In reality, the only way left to increase farebox recovery is to either increase fares or remove marginal services (likely to be weekend or late-night services, and those outside the main centres).

Most councils have their own farebox recovery policies which are prepared in consultation with the local community. A uniform country-wide policy imposed by NZTA, even if the rates vary between regions, seems unlikely to work. The impact will almost certainly be higher fares.

The policy is silent on many areas, particularly the setting of the targets, and the processes and timelines involved if the targets are not met. While it might be argued that this allows some flexibility regarding these actions, it also means uncertainty for councils, particularly regarding funding, and this is not helpful.

5.1.2 Objectives and principles

NZTA justify the policy because it will supposedly increase efficiency, and ensure fairness between all the parties contributing to the cost of providing services. But efficiency is not improved by simply having a higher farebox recovery - efficiency relates more to the way the service is provided (through minimising costs etc) than it does to fare levels.

And while it might be appropriate to ensure all contributors to the costs contribute a “fair” amount, just what is fair is not defined. That is where the research is required.

The Government Policy Statement on Land Transport Funding, and NZTA’s own funding priorities, indicate that funding should be targeted at *those services that have the potential to make significant improvements in peak-time*

public transport patronage in major urban areas with severe congestion. This would indicate that more funding should be provided to places such as Auckland, Wellington and Canterbury than places without severe congestion. Yet the likely consequence of the proposed NZTA policy is that Auckland, Wellington and Canterbury will be required to have higher farebox recovery levels, and thus lower levels (in terms of the percentage of total costs) of NZTA subsidy.

However the real objective of this policy appears to be to restrict the growth in NZTA subsidy payments. That is a valid objective, and the policy could be clearer and far simpler if NZTA adopted that as its objective. The policy is confused and unclear because it purports to have one thing (efficiency) as its objective when its real aim seems to be to reduce subsidy payments.

NZTA could still encourage efficiency improvements and patronage growth (by providing guidance as to how this might be achieved, best practise examples, and benchmark targets etc), but within the framework of reducing subsidy payments.

5.1.3 Justification for recovery targets

No evidence has been provided to justify requiring higher farebox recovery rates. The justification given for the proposed 50% recovery rate proposed for Auckland, Wellington and Canterbury is simply that *“it is reasonably close to what ARTA, GW, and ECan are already achieving, but still constitutes a stretch target or a reasonable and challenging target to continue to achieve”*.

The rates for the other regions seem likely to be set on a similarly ad hoc basis.

NZTA plan to carry out research after the policy is in place. But it would be preferable to do this first, or at least prior to setting the targets so that the targets could at least be based on some research or at least best practise.

Fares cannot just be raised constantly to try and reach some arbitrary target. Fare elasticities come into play, whereby patronage decreases as fares increase, and at some point fares will result in less passengers (as passengers decide to take alternative travels options). There is an optimal point where fares and patronage are at a point where both are maximised. This is what the NZTA research should seek to ascertain.

5.1.4 Tail wagging the dog

NZTA justification for setting the policy is that NZTA are a substantial contributor to the costs of providing public transport. However the region actually contributes approximately 75% of the costs, by way of fares and rates, yet it is NZTA that is dictating the policy.

It is not inappropriate that NZTA should seek to limit its contribution – like everyone else its funding is under pressure. But at the same time it should allow regions such as Southland to adopt a low fare policy, but on the basis that Southland will pay through increased ratepayer contributions if its policy falls below NZTA thresholds.

Thus it might be appropriate for NZTA to limit its funding to say no more than 25% of the total costs, and allow each region to decide the appropriate mix of fares and rates to cover the balance e.g. a region could set its farebox recovery target at 40% of costs meaning (if NZTA is limiting its contribution to 25%) the rates contribution will be 35%.

If NZTA was to limit its funding to a percentage of total costs, and allow councils to determine the level of fares and ratepayer contribution, this would result in a much simpler policy (no need for complex reporting, intervention hierarchies, funding adjustments etc).

5.1.5 Option 1 or 2?

The discussion document asks councils to choose between two options for setting targets (with ultimately only one being available to regions). In essence, regions can choose between option 1 - setting their own targets, or option 2, which for Auckland, Wellington and Canterbury involves a NZTA imposed target of 50%, and other regions setting their own targets.

NZTA seem to prefer option 2 which involves setting a 50% target (the document states that setting a 50% target for the larger regions “*is justified and reasonable*”) because it is similar to targets already set by those regions, and it places emphasis on regions where the biggest gains in terms of operational efficiencies and patronage growth can be made.

Option 1 (each council, including Auckland, Wellington and Canterbury, setting their own target) seems preferable in that it allows councils to set a target that is appropriate to its region. Regional variances (such as variety of modes, population numbers and geographical issues, and current patronage and fare levels) can then be taken into account. Varied targets (and the ability to change them) will also be appropriate when additional costs (rail capital costs and administration) are included in the formula to calculate the farebox ratio.

However the full distinction between the two options is not clear from the discussion document (see comments below), and some clarification has been sought from NZTA.

It seems probably (given the difficulties that the other regions will have in reaching a 50% target) that Auckland, Canterbury and Wellington will end up with higher farebox recovery targets than the other regions. This raises an equity issue, particularly if the main focus of NZTA is supposed to be on traffic congestion.

5.1.6 Impact on this region

At first appearance it might appear that:

- This region is likely to be least affected of all regions from the proposed policy;
- Wellington is receiving proportionally less funding from NZTA because of the low farebox recovery rates of the other regions; and

- The introduction of the proposed NZTA policy would likely result in more funding to Wellington from NZTA (or more likely, GW would receive smaller cuts than everyone else).

But this is a short-term view – when rail capital expenditure and administration/network costs are included in the calculations this will have a significant impact on the Wellington farebox ratio i.e. it will reduce. Depending on how the rail capital costs are calculated, this may have an impact of about 5% on the ratio. Likewise for administration and network costs, which are relatively high in Wellington than elsewhere because of the complexity of the Wellington network.

It should be made clear in the policy (because it isn't now) that if the formula for calculating the farebox recovery ratio is to change, then the farebox target (specially if it is set under option 2 at 50%) will need to be renegotiated.

5.1.7 Externalities

The policy ignores the impact of externalities on the farebox recovery ratio. Large fluctuations in the price of petrol have recently been the major influencer of public transport patronage (and therefore changes to farebox recovery). Other external factors such as the state of the economy, and demographic and land use factors, also affect farebox recovery.

Councils work hard to improve efficiency and increase patronage, but in reality the major influencers, particularly of patronage, are beyond the control of councils. These external factors must be taken into account when considering if a target has been met. The NZTA policy is silent on how this will happen (and how any funding adjustments might be made should the targets not be met).

5.1.8 Commercial services

Commercial services are always a difficult issue when calculating farebox recovery. While it is desirable to include the costs, revenues and patronage from commercial services to obtain an overall picture of what is happening in a region, obtaining this information is often difficult or impossible. While NZTA have proposed a method to try and get around this problem, revenue information is still needed, and this may be difficult to obtain. Because of the number of commercial services operating in Wellington and Auckland in particular, this will make the calculating of the ratios difficult (and potentially inaccurate).

At the moment when calculating the farebox recovery councils usually don't take into account all commercial services (councils often don't know about all of them, particularly privately arranged school services). But the NZTA policy will encourage councils to include as many commercial services as possible in the calculation of the farebox recovery ratio as this will be a way of increasing the ratio.

5.1.9 What happens if targets are not met

The policy is silent/unclear about what happens if the target (or even the three year implementation path) is not met. It is not clear when the intervention hierarchies are to be implemented. And how much time is to be allowed to see if they work? And what happens if they don't? And is any subsidy adjustment to be retrospective? As indicated above, while some degree of flexibility is desirable, uncertainty is not. The policy needs to be clearer on this.

5.1.10 Reporting

The draft policy requires councils to report on various issues, including on any individual "service" (defined as a service operating on a distinct route) that "is falling below" 25%. Also required to be reported on is the ratio for each "centre" (not defined) within the region. Does this mean that this region will have to report separately on Wairarapa, Otaki, Kapiti, Lower Hutt, Upper Hutt and Wellington? And it is certain that centres such as Otaki and Wairarapa (and probably Kapiti and Upper Hutt) are not achieving anywhere near 50% farebox recovery.

Given the integrated nature of services in this region, such reporting will be virtually impossible. For example, such a policy would require rail costs to be split by line, and many bus services are an extension of the rail service.

This all indicates that the policy will be applied by NZTA on an individual service basis rather than on a network wide basis. Yet our planning is based on a network basis and given the feeder nature of many of our services it makes more sense to do that.

5.1.11 Transport disadvantaged

The objectives of the review (improving efficiency and effectiveness) are potentially at odds with the legal requirements of NZTA and councils to take into account the needs of the "transport disadvantaged" when preparing funding programmes.

Many services are provided for the transport disadvantaged, and this is recognised in GW policy whereby there are different farebox recovery thresholds for different types of services (school services, and shopper type services for example). Concessionary fares are also provided as a response to this requirement.

These "social services", which might also include weekend and late-night services, are less profitable than, for example, peak time services. And it is arguable that the services are efficient or effective. Under the NZTA policy these social services will be the first to be cut as it is these services that have the lowest farebox recovery.

It is not clear how the NZTA policy takes account of the needs of the transport disadvantaged, or how this will be recognised when setting farebox targets (or in fact how, when NZTA provides its subsidy, this requirement to recognise the

needs of the transport disadvantaged is balanced against the aim of relieving traffic congestion).

5.1.12 Regional Public Transport Plan

The NZTA proposal requires that each region include its farebox recovery target in its Regional Public Transport Plan. However that Plan is subject to extensive consultation processes, which means the farebox target itself is also subject to consultation. And that is entirely appropriate – the community having an input into what an appropriate farebox target should be. But the NZTA draft policy assumes/implies that the target is agreed between the region and NZTA, and not then subject to community input.

5.1.13 Timing and funding implications

There are several timing issues associated with the proposed policy. Firstly, the policy has to be incorporated into the Regional Public Transport Plan. This involves a lengthy development/consultative process (and an appeal process). Then the actual fare recovery rate for a year has to be calculated, but this cannot be done until the end of the year.

Then if the target (or transition target) has not been achieved, the intervention hierarchy is then presumably applied. The effect of these interventions will take some time to flow through the system. For example, it will take time to see if any efficiency initiatives are successful. And it will also take time (years?) to see if any attempts to increase patronage are successful.

And if after that length of time the targets are still not achieved, fares have to be increased. It takes months to implement a fare change, and then time has to be allowed to see the impact on the recovery ration of the fare increase.

Only after all that time (which may be several years) will it be able to be ascertained if the target has been achieved. And then what happens if, even after a council has done all that is possible to reach the target, the target is still not met? Will NZTA retrospectively adjust subsidies?

The policy is not clear on this, yet councils need to know and plan for the impacts on their budgets.

5.1.14 Rail Capital Costs

The proposed formula for the calculation of the farebox recovery ratio does not include rail capital costs, but NZTA is proposing that these costs be included at some stage in the future.

While it may be appropriate to include some rail capital costs, there will be some debate about some of the costs, especially those related to improving or maintaining the fixed infrastructure. If capital charges are included in any future calculations they should exclude any asset expenditure that has been fully funded by the region and be based on historical costs and not any subsequent revaluation.

The costs of providing a bus service do not include those relating to the building or maintenance of the roads (other than RUC costs); likewise train costs should not include any costs associated with improving or maintaining the fixed rail infrastructure.

5.2 Summary

The draft policy assumes that increasing farebox recovery will lead to improved efficiency and fairness. But farebox recovery has nothing to do with efficiency, and NZTA provides no evidence to support its fairness objective.

The draft policy is vague in several areas, and its implications should the targets not be achieved are unclear. That will lead to uncertainty and disputes.

The main problem areas with the policy as it is proposed are:

- Confusion with the objectives
- Lack of detail, including implementation processes, funding implications, and timing issues
- Disregard for network integration and service linkages
- Lack of regard for the wishes of the community who provide the majority of the funding of PT services
- Uncertainty regarding treatment of services for the transport disadvantaged.

It is clear that NZTA wants to slow the increase in NZTA subsidy payments, and this policy is aimed at doing that. This increase in demand for funding appears unsustainable and it is important that NZTA address it. It is also a matter that should concern all councils. But it is suggested that there are better and simpler ways to achieve the NZTA objective.

5.2.1 Alternative policy

As an alternative to the proposed policy, it is suggested that NZTA simply limit its funding to a percentage of the total costs of providing public transport in each region. Thus it might limit funding to say 25% of costs in Auckland, Wellington and Canterbury (equivalent to farebox recovery rate of 50%), and 30% elsewhere (equivalent to 40%). And each region should be able to determine its appropriate mix of fares and ratepayer contributions.

Such a system would allow NZTA to achieve its objective of managing its funding. It would be much simpler to implement, and would not need complicated calculations and reporting regarding fare recovery.

5.2.2 Draft submission

A draft submission is at **Attachment two**.

6. Fare policy decision making guideline

Associated with the NZTA draft farebox recovery policy is a NZTA draft guideline for reviewing fare structures. The farebox recovery policy requires that fare prices be reviewed annually and that fare structures be reviewed every three years; the draft guideline is to help with the fare structure review process.

NZTA is seeking comment on the Guidelines.

A six stage fare structure review process is suggested by NZTA:

- **Define and prioritise fare policy goals.** Goals might include maximising ridership, and achieving revenue recovery targets.
- **Evaluate fare system options.** Fare systems focus on technology, and include methods for paying, such as at barriers, when boarding, conductor validation, and proof of payment.
- **Develop fare structure alternatives.** Alternatives might include flat fares, distance based fares, and time based fares (e.g. peak and off-peak). The alternatives should be evaluated.
- **Calculate ridership and revenue impacts** of the fare structures
- **Evaluate alternative fare structures**
- **Select fare system and structure**

Essentially the guidelines require that a complete (and very thorough) review of the entire fare structure take place at regular intervals. A process for this review is suggested, which includes developing and evaluating alternate fare structures against various criteria.

The draft guideline suggests fare structures be reviewed at least every 3-5 years (in this it conflicts with the draft farebox recovery policy which states that fare structures be reviewed every three years), and that fare prices should be reviewed annually.

Reviewing fare prices annually occurs now in this region and is a relatively simple and worthwhile exercise. However reviewing a fare structure every three years will be very onerous, particularly if a change was to be made. A review every five years is more manageable. Most of what is suggested in the Guidelines seems sensible, although it is arguably “over-the-top”.

7. Communication

No communication is required.

8. Recommendations

That the Committee:

1. ***Receives*** the report.
2. ***Notes*** the content of the report.
3. ***Agrees*** to send the attached submission, as amended at the meeting, to NZTA, and delegates to the Committee Chair responsibility for approving any editorial changes to the final submission.

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Attachments:

1. NZTA draft farebox recovery policy
2. Draft GW submission on NZTA farebox recovery policy