Bus Franchising Masterclass

Tyne and Wear Quality Contracts Scheme

This Presentation

- Why a QCS?
- What is the QCS?
- Designing the QCS
- How was the case made for the QCS?
- What important risks and issues halted the QCS?
- How has legislation changed?
- What are the main lessons for authorities looking to develop a bus franchising proposition?

Why a QCS?

- Tyne and Wear is fertile bus territory
- But Tyne and Wear faces a potential bus crisis:
  - Bus ridership is falling (down 58% since 1985, down 8% since 2011, down 3% in last year)
  - Bus networks are retracting and accessibility reducing (down 31% since 1995, down 8% since 2011, down 2% in last year)
  - Funding for bus services is under pressure (Tyne and Wear levy down £15m since 2010, further funding shortfall is forecast between now and 2020 as levies reduce and costs increase)

Why a QCS?

- Previous forecasts indicated that ENCTS will swallow entire levy by 2025, assuming funding remains at 2014 levels
- This is not a situation unique to Tyne and Wear, most authorities have cut secured bus services and some have eliminated them
- Tyne and Wear decided to take bold and decisive action, use reserves to retain bus services in the short term and seek a new delivery model for buses – **the Quality Contracts Scheme**

What is the QCS?

- The QCS would remove on-street competition and replace it with competition for operating contracts
- Existing operators and new entrants would compete for contracts on a broadly equal footing, driving down prices
- Operator profit margins required to fund investment in staff, vehicles, facilities
- Local transport authority determines network and sets fares – and accepts the associated risks

Designing the QCS

- Focus on what research shows passengers value:
  - Stable and growing bus network
  - Simple and affordable fares
  - Improved customer standards
  - Integration with the Metro and rail
  - A public say in how bus services develop and change
- Plus from a political perspective:
  - Affordable for the public purse, and a smooth transition

Designing the QCS

- These outcomes led to the QCS proposition:
  - Stable networks that would change only once a year
  - Fares that would be reduced, simplified, smart (with PAYG fare capping) and integrated, with increases pegged to inflation
  - Simple discount fares for under 19s and students
  - Improved vehicle standards – age and emissions
  - A customer charter that sets standards for punctuality, reliability, branding, information and customer service
  - Protections for bus operator employees

Designing the QCS

- Contract Procurement is key to achieving outcomes. There are three key (and competing) considerations:
  - Potential adverse impacts on incumbent operators are minimised
  - New market entrants and incumbent operators can compete on an even playing field
  - The welfare and conditions for bus industry employees are protected and enhanced
- Contract lots were defined to balance these three considerations, and provide investment certainty

Designing the QCS

- Developing the contract documentation was a significant task, bid document designed to:
  - To provide an attractive proposition for all bidders
  - To ensure that achievable and affordable service standards were set, based on current performance
  - To ensure that suitable incentives were in place to encourage good performance and discourage poor performance, eliminating perverse incentives
  - To ensure that value for money was delivered

Designing the QCS

- Planning the transition and transformation from an early stage is critical:
  - The roles/responsibilities moving from operators to LTA
  - The contracts management team structure required once QCS is established
  - The resources needed to plan and execute the transition
  - The costs and resources required to deliver on QCS promises – smart ticketing, customer care, etc

Designing the QCS

- Managing the contracts:
  - Reliance on AVL to monitor performance, based on achieving standards at timing points
  - Criteria defined for flexible operation – turning short when running late, without incurring lost miles penalty
  - Regular contract review meetings, escalating contract remedies for poor performance
  - 15 strong contract management team (6 today)
  - 6 strong network planning team (3 today)

Designing the QCS

- Annual Service Review process
  - Based on business planning principles – review performance, assess financial resources, gather public/politician views, propose changes for consultation, amend and implement
  - Inevitable lag in delivering changes – could be up to 18 months
  - Emergency procedure also provided for, to deal with circumstances where changes were forced upon us, or "no-brainers"
  - Work starts well in advance of "Day 1"

Designing the QCS

- Cross Boundary Services
  - Significant issue in Tyne and Wear – 30% of bus services cross the boundary to Durham or Northumberland
  - Proposal to procure services for full length of service including across the boundary, with fares and standards set throughout the route
  - Contingency sum set aside for neighbouring authorities to mitigate any impacts on remaining commercial services within their area

How was the case made for the QCS?

- LTA 2008 required a public interest test (PIT) to be "passed", based on five elements:
  - Increase the use of bus services
  - Provide benefits to bus users
  - Contribute to local transport policies
  - Is economic, efficient and effective (the 3Es)
  - Proportionate in balancing adverse effects on operators with well-being benefits to people living in the Scheme area

How was the case made for the QCS?

- The assessment of all five elements of the PIT were underpinned by two bespoke bus industry models:
  - A patronage, revenue and financial assessment
  - An economic appraisal model
- The base financial assessment model was developed from available data – industry cost indicators, bus operator accounts, local patronage and ticket sales data
- A key issue was that operators' data was not made available, when requested

How was the case made for the QCS?

- Forecasts for the base case scenarios were developed based on:
  - National and local forecasts of industry costs
  - Forecast changes to the secured bus network arising from funding cuts and ENCTS reimbursement growth
  - Extrapolation of past trends in bus fare increases (with respect to inflation)
  - Demand elasticity used to assess the implications of network and fare changes
  - Contraction of commercial network not modelled

How was the case made for the QCS?

- Forecasts for the QCS and partnership scenarios were developed based on:
  - Bus networks and fares commitments (elasticities)
  - Retention of the secured bus service network
  - Assumptions about acceptable profit margins for successful bidding operators
  - Implications of "soft factors" (customer charter, simplified fares, network stability, customer input on changes, etc) converted to time/cost savings
  - A contingency sum top-sliced from revenues (~6%)

How was the case made for the QCS?

- These scenario tests provided aggregate forecasts of bus patronage, fare revenues, scheme benefits (expressed in journey time units) and operating costs that fed into the economic evaluation model
- This economic appraisal model:
  - Received input data from the financial model
  - Undertook risk modelling based on 10,000 scenarios to determine a risk profile
  - Identified a median risk outcome, which was used as a central case economic evaluation forecast

How was the case made for the QCS?

NEXUS

- The headline results were that:
    - Patronage would decline in the base case scenario, operator profit margins maintained
    - QCS delivered 90 million more journeys and £280m of economic benefits over ten years
    - VPA proposed by operators would deliver 44 million more journeys and £200m of economic benefits over same timescale (extra services, improved fares)
- A separate evaluation of adverse impacts on operators was conducted, based mostly on consultation responses - ranged from £85m to £226m

What risks and issues halted the QCS?

- QCS Board opinion was negative, boiled down to three issues:
    - The economic appraisal presented by Nexus was not sufficiently convincing or evidence based;
    - The treatment of cost risks associated with the QCS was insufficient; and
    - The adverse impacts on bus operators could not be considered proportionate to the wellbeing benefits – indeed QCS Board considered that Parliament did not have in mind a scheme with such adverse effects

What risks and issues halted the QCS?

- Predicting the future – the curse of being first
  - Some key assumptions had no precedent, or could only rely on extrapolating past trends – future commercial fares, bidder profit margins
  - Assumptions about rational responses of operators to future pressures were challenged
  - The adoption of risk was a major issue – despite the bus industry being a low risk industry where changes tend to happen slowly and predictably
  - Nexus' analysis of risk did not build in mitigating actions

What risks and issues halted the QCS?

- Doubts cast over the economic analysis
  - The novel requirements for the appraisal left us open to arguments about our approach
  - The treatment of ‘soft factors’ associated with a better public transport offer suffered from lack of evidence and esoteric arguments about detailed methods
  - The economic analysis and the risk assessment contained mistakes that were only revealed and corrected late in the day, which affected the credibility of the Scheme
  - The treatment of Optimism Bias was not addressed

What risks and issues halted the QCS?

- The characterisation of risks
  - The concept of a government authority accepting commercial risk was not supported – hints that it would all go wrong
  - Downside risks were allowed to become paramount in the discussion, upside risks (of which there were plenty) were not emphasised
  - The bus industry was characterised as a high risk undertaking – which simply isn't the case
  - The ability of Nexus to mitigate risks in an orderly manner was not accepted

What risks and issues halted the QCS?

- The flaws in the QCS process
  - The QCS was limited to ten years – which limited the benefits of the Scheme and the ability to make long term changes. Plus, it left a Year 11 cliff edge
  - The lack of guidance – we had to make it up as we went along, which left us open to challenge
  - The public interest test hurdles – which coupled with the above, made forming a compelling water-tight case extremely difficult
  - The QCS Board – a year and £000,000s to take three people through a highly intricate proposal

How has legislation changed?

- The bus franchising powers in the Bus Services Act are a massive improvement on the QCS legislation:
  - LTAs can obtain operators' data on costs, patronage and revenues
  - The timescales for bus franchising are open-ended
  - There is no public interest test hurdle – replaced by issues that LTAs must consider before proceeding
  - The appraisal process is based on establishing Green Book principles, not bespoke and weak guidance
  - There is no independent Board scrutiny – replaced by a much more useful independent audit

How has legislation changed?

- There remains some weaknesses…
  - The need for LTAs to seek Secretary of State approval before progressing a business case, and lack of clarity around what information the SoS requires
  - The potential limitations of service permits for cross-boundary services
  - The lack of clarity around adverse effects on operators (e.g. are lost profits really "lost"?)
- But that said, the franchising powers are a major step forward

The lessons to be learnt

- Manage expectations for the scheme – set clear parameters for network growth and fare increases, hardwire them into analysis to ensure affordability
- Develop your scheme appraisal carefully, based on experience:
  - Disaggregate by corridor to identify and mitigate differential effects, avoid a 'black box' approach
  - Undertake local research to back up claims about 'soft factors' benefits, and apply findings carefully
  - Spend time and money on thorough and timely audit

The lessons to be learnt

- Undertake risk assessment that builds in a degree of mitigation – and address the issue of optimism bias
- Don’t forget the employees –
  - TUPE and pensions protections apply in the Bus Services Act
  - But employees and TUs may need more reassurance
  - Start early on engagement and consider additional protections – they will smooth the transition

The lessons to be learnt

- Some final detailed considerations
  - The availability of depot space is critical to attracting non-incumbent bids. Identify land, prepare outline design, seek outline planning permission
  - Plan your procurement carefully to foster competition from large and small operators, incumbents and new entrants
  - Avoid grand improvements to high cost items from day one – for example LEBs. Asking the same revenue base to purchase additional investment on day one will strain your finances. Evolve, don't change radically