

Date: 27 November 2013

Item 9: **Achieving Value for Money in the Delivery of London's Bus Service**

This paper will be considered in public

1 Purpose

1.1 The purpose of this paper is to brief the Committee on:

- (a) how the planning, tendering and contract and performance management processes are driven to secure value for money;
- (b) reductions in bus network costs over the last five years;
- (c) bus operator profit margins;
- (d) accommodating growth in demand within constrained funding; and
- (e) service priorities and trade-offs based on achieving a hypothetical 20 per cent saving.

2 Recommendation

2.1 **The Committee is asked to note the paper and the related paper on Part 2 of the agenda.**

3 Introduction

3.1 Tendering of the London bus network, which commenced in 1985, is conducted in accordance with the negotiated procurement procedure under the Utilities Contracts Regulations 2006.

3.2 The planning, tendering, contracting and performance management arrangements have been continually developed. They are recognised as being mature and effective by the Independent Investment Programme Advisory Group (IIPAG) and internationally, as cities and countries seek information on London's experience. They are also well understood by bus companies. They are designed to deliver value for money, balancing passenger and stakeholder expectations against cost. TfL has an extensive understanding of the cost of operating bus services in London and maintains a comprehensive cost model to ensure value is achieved in all contract awards and service changes.

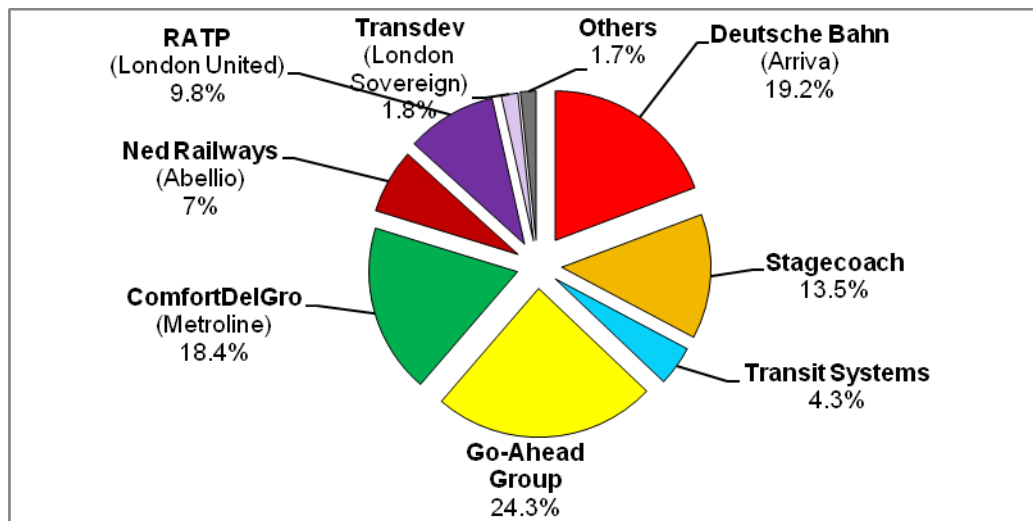
- 3.3 The July 2013 IIPAG Benchmarking Report, notes that “the franchising approach appears well developed and TfL has a good understanding of the underlying costs and how these compare between providers. A rolling programme of competition enables regular analysis of costs and drivers of costs” and that “the cost and performance of London Buses compares well with international comparators” and are “better than median for all main measures and top quartile for most”.
- 3.4 The IIPAG Benchmarking Report concludes that “London’s Buses are among the best in the world” and recommends that “the current approach to delivering bus services is maintained, including the engagement with the International Bus Benchmarking Group, which should be kept under review for new initiatives elsewhere”.

4 How value is achieved

Market Development

- 4.1 TfL actively engages with the London bus market through ongoing dialogue with existing operators and potential new entrants, to ensure that appropriate levels of competition are maintained.
- 4.2 Within its contracts, TfL has the right to approve or deny any change of control or ownership of an operator and will only approve an acquisition where it considers this is not detrimental to competition.
- 4.3 Although there has been consolidation in the ownership of bus companies, which is a UK-wide trend, the market for London tendering remains competitive with, on average, three bids received for each route tendered. Some recent examples of productive competitions are:
- (a) following extensive discussions between the parties and ultimately approval by TfL, Transit Systems Pty Limited (an Australian owned company) has recently entered the London market, by the acquisition of the assets and contracts that operate from three former First Group garages; and
 - (b) a contract has recently been awarded to a new entrant to the London market, TGM Group Limited (an Arriva Group subsidiary), providing additional competition in the west London area.
- 4.4 TfL monitors garage capacity and has, where appropriate, intervened through leasing or developing new depots as a means of maintaining or stimulating competition in specific local areas of London. For example, TfL refurbished and re-opened Walworth garage to provide extra capacity and to enhance competition in south central London.
- 4.5 The current market share showing the ultimate owners of the operating subsidiary companies is shown in Figure 1.

Figure 1 Current market share showing the ultimate owners of the operating subsidiary companies



4.6 Additional information regarding Bus Operator competition is included in the paper on Part 2 of the agenda.

Tendering

4.7 A synopsis of the main features of how the bus network is tendered and evaluation is undertaken is described in Appendix 1.

4.8 Central to this is that a detailed cost model has been developed and maintained by TfL over many years, providing a comprehensive understanding of cost components for bus operation in London. This is used as the basis for ensuring that value for money is being achieved with negotiations undertaken as necessary, in accordance with procurement regulations.

4.9 Additional information on how TfL tracks and monitors a range of key financial performance indicators is included in the paper on Part 2 of the agenda.

Contract and Performance Management

4.10 The contracting system is continually being refined and developed. It is fundamentally an output based contract, where TfL specifies the levels of service required and the bus operators deliver to the standards set.

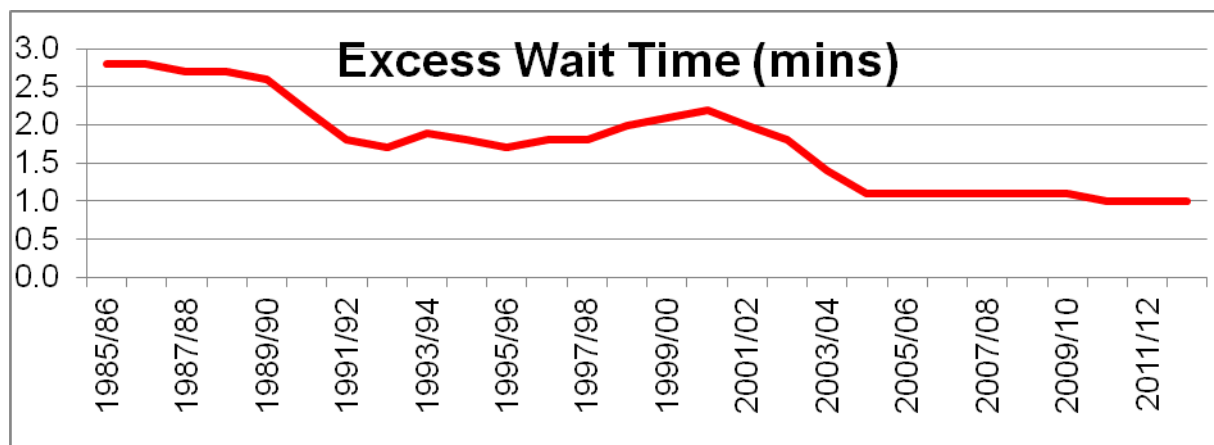
4.11 There is a range of performance monitoring systems in operation covering all aspects of service provision, which have seen a considerable and sustained increase in quality standards since the 1990s. These improvements have in turn led to increased ridership and improved customer satisfaction. The key measures used to incentivise route level operational performance financially are:

- (a) deductions are made from contract payments for mileage that is not operated;
- (b) performance payments based on the reliability of the service; there are bonus payments relating to performance on excess wait time (EWT) on high frequency routes and on time departures for low frequency routes, that are better than the standards set by TfL and deductions made where performance is worse than the minimum standards; and

- (c) potential two year contract extensions, where reliability is significantly better than the minimum standards (contracts are generally for five years with a potential two year extension).

4.12 Figure 2 shows the improvement in EWT over the last 30 years. The current budget envisages that EWT will be maintained at, or about, current levels. Any deterioration would have a negative impact on ridership and customer satisfaction.

Figure 2 Improvement in Excess Wait Time over the last 30 years



5 Reductions in Bus Network Costs

5.1 Bus contract costs per kilometre have fallen by five per cent in real terms since 2008/09. Despite fares increases in real terms, demand has risen by four per cent. The combined effect is a real-terms reduction in the subsidy per passenger journey (PPJ) from 28p in 2008/09 to 16p in 2012/13.

Table 1 Reduced levels of Bus Network Subsidy from 2008/09 to 2012/13

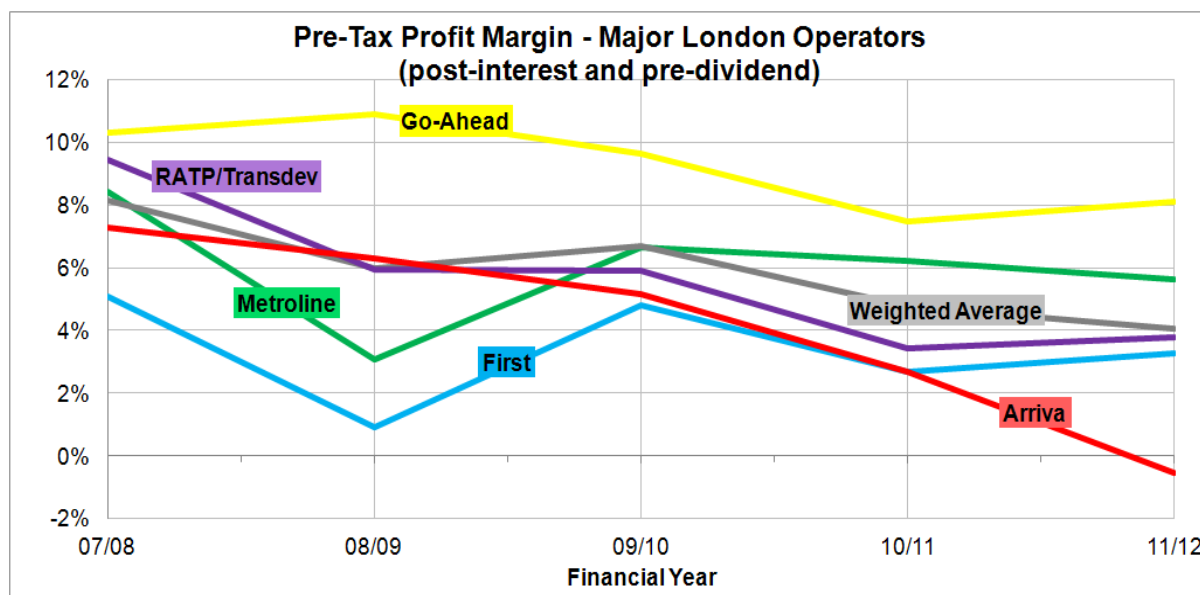
Bus Network Subsidy	2008/09	2009/10	2010/11	2011/12	2012/13
Total Subsidy (£'m-12/13 prices)	633.2	612.8	465.2	406.0	367.5
Subsidy PPJ (pence)	0.28	0.27	0.20	0.17	0.16

- 5.2 A significant influence on subsidy is the level of fares and the policy in respect of free or discounted travel for Oyster 60+ London pass holders, students and children, veterans and apprentices.
- 5.3 Savings continue to be delivered on bus contracts. Included within the TfL Efficiencies Programme, buses have contributed £303m of savings from 2009/10 to 2012/13. These included efficiencies from the rolling annual competitive bus route tendering programme, operational savings from the introduction of iBus and sale of East Thames Buses.
- 5.4 Contained within the Bus Network subsidy is the capital investment made by the bus operators for premises, vehicles and machinery. The average annual capital investment by the operators in the London bus fleet is approximately £200m per annum.
- 5.5 Additional information regarding TfL's savings and efficiencies programmes is included in the paper on Part 2 of the agenda.

6 Profitability

- 6.1 TfL undertakes ongoing analysis of the London bus company profitability. The pre-tax profit margins earned by the major London operating groups, as reported in published accounts (those companies above five per cent market share), for each of the last five years are shown in Figure 3.

Figure 3 Pre-tax profit margins of London's major Bus Operators in the last five years



Note 1 Stagecoach, which sold its London bus business to Macquarie Bank in August 2006 and repurchased it in October 2010, has been excluded.

Note 2 FirstGroup, which recently sold its London business, is included.

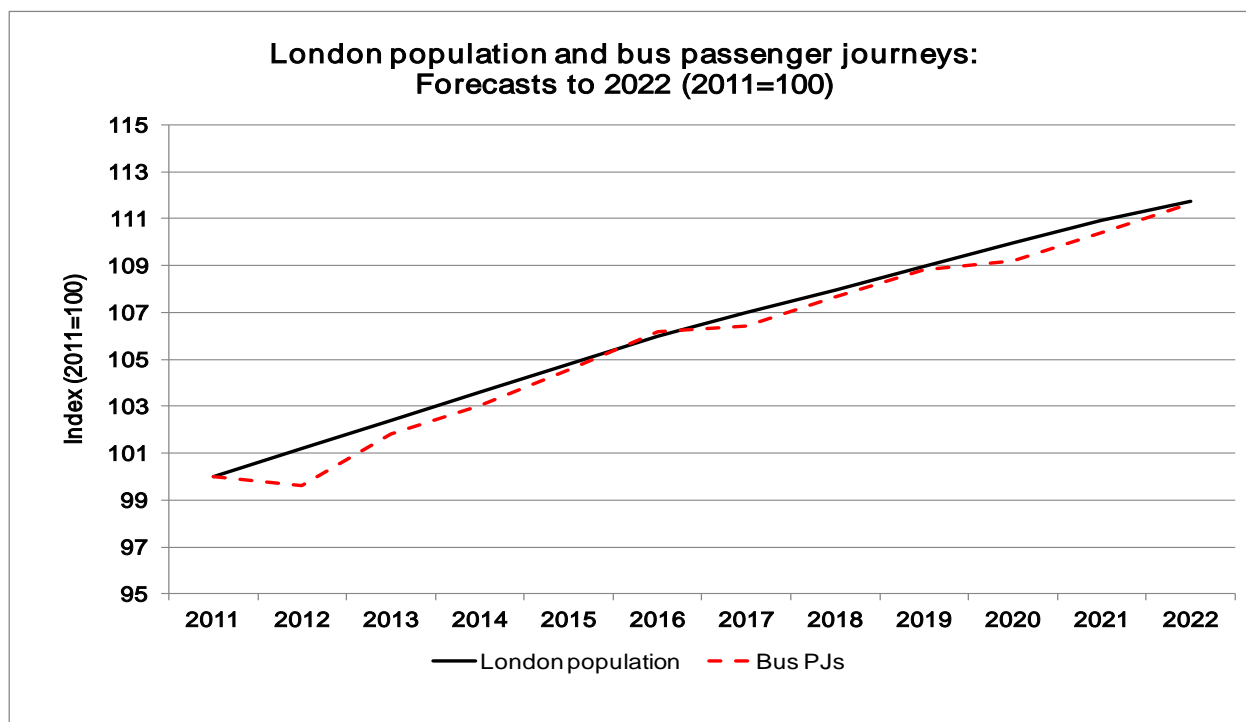
Note 3 For the period covered, Transdev owned London United and London Sovereign and had a combined market share of approximately 10 per cent.

- 6.2 The average profitability, weighted by market share, shows that at a network level profit margins have declined from eight per cent in 2007/08 to four per cent in 2011/12.
- 6.3 In addition to pre-tax profit margins, TfL also monitors operators' Return on Capital Employed (ROCE). This is very volatile however due to vehicle acquisition and how operators account for operating leases.
- 6.4 Additional information on bus operator profitability is included in the paper on Part 2 of the agenda.

7 Accommodating growth within constrained funding

- 7.1 The bus network has grown substantially over the last decade with 38 per cent more people using it now compared to 2003, and 23 per cent more kilometres operated. Passenger demand is forecast to increase by approximately eight per cent between 2013/14 and 2021/22. The current Business Plan is based on an assumption of no changes to the overall level of bus kilometres in 2013/14 and 2014/15, followed by growth of approximately four per cent between 2015/16 and 2021/22, i.e. around one per cent per annum.

Figure 4 Graph showing actual and forecast London population versus bus passenger demand



- 7.2 There are no detailed forecasts for bus demand beyond 2021/22 but the planning assumption is for growth to continue broadly in line with population. Between 1998/99 and 2012/13 bus passenger journeys grew around four times as fast as population but this was also being driven by service level/quality improvements and by fares policy.
- 7.3 By ensuring that services are in the right places in relation to changes in demand, and by helping to ensure that they are structured to enable reliable operation, the network planning process as outlined in Appendix 2 has been one of the significant factors behind the successful growth of bus usage in London to date. The process also ensures that each local requirement is being appraised in the same consistent way across the network, thus supporting answers to queries and challenges during the consultation process.
- 7.4 The process deals consistently with service increases and service reductions. Moving resources is integral to network planning. Recent examples include changes to routes 38, 44 and 77 in early spring 2013. Following a review, route 38 (Clapton Pond – Victoria) was reduced from about every 2.5 to every 3 minutes whereas extra peak capacity was introduced on routes 44 (Tooting-Victoria) and 77 (Tooting-Waterloo). Similarly in south London, the frequency of route 12 (Dulwich – Oxford Circus) has been reduced while there have been increases on routes 40 (Dulwich – Aldgate) and 63 (Honor Oak – King’s Cross).
- 7.5 In some cases growth can be accommodated without changes to bus mileage, for example where it is in a location which generates travel against the current peak, or where using bigger vehicles on a route is the most cost-effective response, for example double-deck for single-deck.

- 7.6 New rail capacity will change bus trip patterns. For example, with Crossrail shorter trips to suburban stations will increase and there will be some reductions in longer trips. The shorter trips are, generally, cheaper to provide. Where passengers cannot be accommodated, in order to provide sufficient capacity at peak times it may be necessary to re-allocate resources from quieter, off-peak periods.
- 7.7 Improvements to conditions for walking and cycling should attract some shorter trips from bus, though there are likely to be significant seasonal variations.
- 7.8 In order to manage the growth within the funding available, it will be vital to ensure that the bus network is as cost-efficient as possible and that additional costs are not incurred due to falling speeds. This means ensuring, where appropriate, priority is given to bus services through measures at traffic signals and bus lanes and also that direct routes are available to and within key locations such as town centres which are the hubs of passenger demand. TfL's response to the Mayor's Road Task Force proposes more priority for buses, tackling "pinch points" and supporting the high quality bus priority corridors, especially where they can help unlock new development such as in the Barking Riverside development.

8 Approach if significant reductions in funding were required

- 8.1 If further significant reductions in funding (i.e. beyond the savings being generated through existing efficiencies) become necessary, the strategy for implementing cuts would follow on from consideration of the options for both services and fares policy and fares levels, as is normal for each business planning round.
- 8.2 For service reductions, the planning process described in Appendix 2 would continue to form the basis of the changes required to reduce subsidy. This is to ensure that the final network after the reductions still represented the best value means of implementing the Mayor's Transport Strategy (MTS) within the available funding. This process would also ensure passenger disbenefits would be minimised.
- 8.3 Peak-time reductions deliver the largest savings. Buses needed only at the height of the peak will have the lowest cost recovery. Savings of this type are therefore always sought as part of the continuous review process (as in the examples quoted in paragraph 7.4 above) and this will continue. However, cuts which would result in inadequate capacity are undesirable and are not being brought forward as this would be in conflict with the MTS in respect of supporting growth and ensuring people have good access to employment and education. In a similar way, school bus services are relatively expensive per passenger carried but support the policy of free travel.
- 8.4 Therefore, while peak services will remain fully in scope for the review process, it is likely that a package responding to a significant reduction in funding would need to contain extensive cuts between the peaks, in the evenings and on Sundays. Such services represent good value for money, attracting new passengers and reflecting growth in 24/7 activity and they are provided at a marginal cost. However, cuts at these times would have less impact on passengers than in the peaks. To minimise the impact on passengers the most effective way would be to reduce a large number of routes by a smaller amount, rather than remove whole services. For illustration, to save £25m per annum some 200 routes would have their mid-day, evening, and Sunday services reduced by one bus per hour (in practice some routes would be reduced by more and some by less than this). The routes involved

and the specific changes per route would be determined using the cost benefit analysis.

- 8.5 Night bus service would also be examined. Demand at night has almost doubled in the last ten years, with some night services carrying loads equivalent to the morning peak. However some suburban night services (generally linking suburban town centres) are less intensively used. Withdrawing the 15 routes with lowest usage would save around £5m per annum.
- 8.6 Services in the outer suburbs with low cost recovery but provided to ensure some accessibility to public transport would also be reviewed. Complete withdrawal of the fifteen outer-suburban routes with lowest cost recoveries would save approximately £4m per annum.
- 8.7 Overall, if such a saving was required, a combination of service reductions and withdrawals would need to be implemented. The number of routes affected and the depth of the cut into peak capacity would depend on the saving required. To illustrate, a package to reduce subsidy by 20 per cent (£65m) by 2016/17 and which excluded any changes to fare levels / fare policies might look like this:

Table 2 Indicative proposals to reduce Bus Subsidy by 20 per cent by 2016/17

Measure	Saving (£m pa)
Cuts to non-peak service on 200 routes	25
Withdrawal of 15 night bus services	5
Withdrawal of 15 outer-suburban low-frequency routes	4
Subtotal	34
Balance to be found from further cuts offpeak (e.g. weekend withdrawals) and peak-time capacity	31
Total	65

- 8.8 This example would mean a reduction of around 10 per cent in the size of the network compared to the current Business Plan. Passenger journeys would fall by around five per cent.
- 8.9 Implementation would need to include statutory consultation with the boroughs, London TravelWatch and other stakeholders. The consultation would need to list each specific route change; its overall form and timing would depend on the required pace of the changes and on consideration of consistency with parallel discussions on other service changes, for example, potential enhancements in connection with new development.

9 Conclusions and outlook

- 9.1 The London bus market is, and is expected to remain, competitive. Profitability in the London market is not excessive and TfL will continue to manage the tendering process to ensure that this remains the case.
- 9.2 The network planning process is designed to allocate resources equitably across the network, maximising the benefit to passengers for any given level of expenditure. Change is appraised in TfL's cost/benefit framework, which is applicable to reductions as well as to increases. Services are developed in the context of extensive current and forecast information on demand and performance,

taking account of stakeholder aspirations and within the trajectory of funding in TfL's Business Plan. The same approach would continue to be used in the event of significant reductions in funding. Maximising the efficient use of resources is also being pursued by maintaining the case for bus priority and, in particular, direct bus access to, from and within London's town centres.

- 9.3 The recent report on bus services from the London Assembly asks the Mayor and TfL to demonstrate how they are meeting the challenge of rising demand for bus travel. The report asks for increased engagement with the boroughs and others to respond to pressures for new and enhanced services. TfL will continue to seek a balance between the ongoing need to support London's growing population and economy and the reality of scarce resources.
- 9.4 Additional information on London's bus market is included in the paper on Part 2 of the agenda.

List of Appendices to the Paper:

Appendix 1: Synopsis of the Tendering Process

Appendix 2: Synopsis of the Network Planning Process

List of Background Papers:

July 2013 Independent Investment Advisory Group (IIPAG) Benchmarking Report

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Synopsis of the Tendering Process

Tendering

- (a) There is a continuing programme of tendering, with between 15 per cent and 20 per cent of the network typically tendered each year. Invitations to tender for groups of routes are issued typically every two to four weeks.
- (b) Routes are tendered individually, but normally at the same time as other routes in the same area. This system has proven to provide the basis of good quality competition while giving opportunities for operators to offer economies/discounts for the award of more than one route.

Evaluation

- (c) Tender evaluation is based on best value for money, taking into account quality and safety as essential features.
- (d) The continuous nature of the tendering system allows TfL to closely monitor any changes in cost elements at a detailed level. It also reduces the risk for both TfL and the bus Operators, by not fixing large proportions of the cost of the network, for long periods of time and consequent step changes upon retender. The financial tender evaluation analyses comprehensive submissions from operators, to ensure the efficiency of all aspect of the tender including:
 - Staff wage rates and other conditions
 - Staff resource proposals
 - Schedule proposals (including the proposed number of vehicles)
 - Service control and supervision proposals
 - Vehicle specification proposals
 - Garage location and staff operational and engineering facilities
 - Overheads and profit.

TfL retunes its own detailed costing model to reflect changes in rates and cost components.

- (e) Evaluation considers the use of new vehicles or existing vehicles, to ensure that the optimum value for money is achieved in the award of each contract and to balance the fleet age profile and technical developments (e.g. environmental developments).
- (f) Separate links to the vehicle manufacturers and leasing companies are maintained by TfL, to ensure that a full understanding of costs is maintained.

Post Contract Award

- (g) Once awarded, contract delivery is closely managed across all aspects, with comprehensive monitoring tools in place.
- (h) Payments are based on the service delivered and overall reliability. The contract structure provides strong positive incentives to operators to actively maintain and improve service quality.
- (i) TfL's cost model is used to forecast and therefore ensure that value for money is secured in mid-term contract changes and route/service alterations, necessitated, for example, by new developments or on the road disruptions.

Synopsis of the Network Planning Process

Strategic direction

- (a) The strategic direction for development of the network is set by the Mayor's Transport Strategy. Services reflect demand, current and forecast, with options for change appraised in TfL's standard framework and provision constrained by a minimum value-for-money threshold and the overall budget. This ensures that funds are spent on the best-available schemes in an equitable way across the network. All services are kept under regular review.

Appraisal framework

- (b) Passengers' responses to service options are modelled using TfL's standard appraisal framework. Parameters include the value of time, weightings to reflect passenger perceptions of the different elements of journey, and the elasticity of demand with respect to cost. The modelling estimates the size of the benefits or disbenefits to passengers of a scheme. These are set against the forecast net cost to produce a benefit /cost (or disbenefit /savings) ratio. Currently the threshold ratio is 2.0 to 1, in other words schemes where extra £1 of net spending would produce benefits worth at least £2 can be considered for introduction if funding is available. In the same way, saving schemes with disbenefits worth less than twice the net savings would be considered worthwhile.
- (c) While quantification is critical, the framework requires non-quantifiable benefit to be considered. There are thus, for example, services running in low-density areas that would otherwise be very remote from public transport. While such services have poor benefit/cost ratios it is recognised that they are a desirable part of fulfilling the goals of the Mayor's Transport Strategy, provided they can be provided at limited net cost. Each case is considered on its merits.

Engagement and monitoring

- (d) The appraisal framework does not generate change of itself. Alongside internal monitoring of reliability, capacity, etc, there is an extensive programme of engagement with stakeholders including the boroughs, developers, NHS organisations and education providers. This is used to understand both general aspirations and specific projects.
- (e) Other sources of planning information include TfL's own strategic transportation models, currently being used to support discussion of Crossrail at the local level with boroughs. Planning documents from both the GLA and boroughs are also used in framing bus network development, including Planning Frameworks, Masterplans and other Local Development Framework materials.