

Minor Routes (Gr. 4) / Route 3 (Gr. 2) Strategy

Ferry Advisory Committee Chairs
Submission to
Ministry of Transportation



June, 2008

Fuel and Infrastructure Costs Driving Ferry Fare Increases

Urgent Need for a Strategic Approach to Coastal Ferry Service on the Minor Routes (Group 4) and Route 3 (Group 2)

A recently announced possible 20% fuel surcharge this summer for the minor ferry routes would be higher than all the previous surcharges combined. We fear that such increases are not sustainable for either the ferry services or the communities they serve. Traffic is consistently declining on the Minor Routes, with vehicles carried in May down over 5000 units to 167,778 from 173,248 in May 2007 (and 179,483 in May 2006) according to BCFerries point of sale statistics. Meanwhile, on the Major Routes where fare increases have not been so severe, vehicle traffic is increasing. This indicates that fares are a significant factor as other influences, such as high gas prices and poor weather, would apply to both route groups.

We reiterate our call – this time more urgently – for the Ministry of Transportation to initiate a strategy to address the viability of the Minor Routes and Route 3 and the communities that depend upon them.

During Performance Term 1 (PT1) - April 2003 to March 2008 - the cost for traveling on BCFerries' Minor Routes increased sharply because of the five 4.4% annual fare increases, the 4% fare increase that set the base for Performance Term 2 (PT2), and the three fuel surcharges (6%, 3% and 9.6%). Combined, these increases amounted to 49.9%, from April 2003 to April 2008. The increases were higher than that for prepaid fares and were over 80% for prepaid fares on some routes. Fares have already become unaffordable for many low and fixed income residents of ferry dependent communities. The declining ridership during the last two to three years of PT1 appears to be a reflection of this.

Looking at Performance Term 2 - April 2008 to March 2012 -, we see no abatement in the rapidly increasing ferry fares.

The Ferry Commissioner has set price caps which, based on 2% increases in the Consumer Price Index, would yield 7.2% annual fare increases. With food and fuel costs threatening to push the CPI higher, annual April 1 fare hikes are likely to be in excess of 7.2%. For every 1% increase over 2% in CPI, the annual fare increase for the non-major routes will be 0.73% higher than the nominal 7.2%.

With escalating fuel prices during the last three months, BCFerries expects the Commissioner's fuel surcharge formula for PT2 to result in another surcharge, quite possibly in the 20% area, this summer. According to Rob Clarke of BCFerries, the fuel cost formula has a set price of \$0.80 per litre of light diesel fuel for the first year of PT2, which corresponds to Texas light sweet crude oil at \$86US per barrel. The average price paid by BCFerries during the month of May 2008 was \$1.20 per litre. Assuming that world market prices will remain around \$130 per barrel, refining costs stay the same and the provincial carbon tax is imposed July 1, there is every chance that a substantial fuel surcharge will be added to Minor Route fares by November 2008, if not sooner.

With the Minor Route fleet in need of new ships, BCFerries has embarked on a vessel replacement program with the commissioning of the MV Kuper (\$12M) and, in the fall of 2008,

the MV Island Sky (\$57M). During PT2 through PT4, fifteen Minor Route vessels and one Route 3 vessel will be replaced at an estimated cost of \$725 million, as per Appendix I. In addition, BCFerries requires upgrades to existing Minor Route and Route 3 terminals costing some \$195 million. This renewal program will result in sharply higher infrastructure costs for amortization and debt financing (Appendix II). These calculations are based on 2007 dollars. Inflation can be expected to force these costs up, possibly dramatically. By way of historical context, Appendix III illustrates how the provincial contribution, the service fee, has more than covered annual capital costs for the Minor Routes and almost covered the capital costs for Route 3 during PT1. This reflects the lack of capital investment in these route groups during the first term.

The very high cost of ferry travel at the end of PT1, tariff increases of a minimum of 7.2% per annum in PT2, the anticipated introduction of substantial fuel surcharges this summer (with more likely to follow) and the high infrastructure costs for the Minor Route and Route 3 fleet renewal and terminal upgrades are certain to have a major impact on the affordability of ferry travel. These added costs and resulting changes in travel patterns may render the routes serving ferry dependent communities unsustainable and could threaten the viability of the whole ferry system, while causing substantial, and irreversible, economic and social trauma to coastal communities.

For the above reasons, the Ferry Advisory Committee Chairs deem it imperative that a Minor Routes/Route 3 Strategy is developed forthwith to assure the sustainability of our routes and the survival of the communities dependent upon them.

A strategy is already being implemented for the Northern Route Group with provincial government financial assistance assured through increases to the Northern service fee to cover higher infrastructure costs as new replacement vessels and terminal upgrades are commissioned. Further ongoing financial assistance is provided by the provincial government through the "Northern Fuel Protection Plan" which will see the government absorb the excess fuel costs that would have otherwise been recovered through fuel surcharges on those routes.

The FAC Chairs are prepared to work with the Ministry and BCFerries to establish the basic parameters of a strategy for the Minor Routes and Route 3. We would welcome discussions with both parties to identify the information and advice we can provide to facilitate our contribution to this process.

We suggest that, as with the "Northern Strategy" and the "Northern Fuel Protection Plan", core terms should be incorporated into the "Minor Routes/Route 3 Strategy" to safeguard the viability of these routes and our ferry dependent communities.

A strategic approach is urgently required both to immediately mitigate the impact of excessive fare-shock and to develop a transportation service that will be resilient to anticipated changing conditions. The absence of such an approach will likely lead to a collapse of BCFerries' business plan for the routes in question and to irreversible damage to the vulnerable coastal communities they serve.

Appendix I –

BC Ferries Current and Future Capital Investments

All amounts in millions of 2007 dollars

PT2 (already commissioned or committed)

Kuper	reassembled Vanc Shpy	\$ 12*	Minor
Northern Adventure	ex Sonia Spain Vanc Shpy	\$106"	Northern
Coastal Renaissance	Flensburg	\$181	Rte 2
Coastal Inspiration	Flensburg	\$181	Rte1
Coastal Celebration	Flensburg	\$181	Rte 30
Island Sky	Vanc Shipy	\$ 57*	Rte 7
Northern Exhibition	Flensburg	\$233"	Northern
Northern Replacement		\$ 54"	Northern

Total (Northern" \$ 393; Major \$ 543; **Minors* \$ 69)** **\$1,005**

Terminals: Nanaimo Horseshoe Bay **\$28.0** (share Rte.8 - \$2.0, Rte.3 - \$5.5)

PT3/PT4 new vessel/terminal expenditures

Group 4 - Minors

New MINOR Vessel: Rt. 24 – Tenaka*	\$13.5	
New MINOR Vessel: Rt. 25 – QQII*	\$24.7	
New MINOR Vessel: Rt. 18 – NIP	\$25.7	
New MINOR Vessel: RT.20 – Klitsa	\$25.7	
New MINOR Vessel: RT. 22 Winter – Tacheck	\$25.7	
New MINOR Vessel: Rt. 22 – Kahloke	\$12.7	\$13.0
New MINOR Vessel: Rt. 24 – Nimpkish		\$25.7
New MINOR Vessel: Rt. 26 – Kwuna		\$25.7
New INTERMEDIATE 185 AEQ Vessel: Rt. 9 – Nanaimo	\$80.0	
New INTERM. 185 AEQ Vessel: Rt. 17 – Burnaby	\$80.0	
New INTERMEDIATE Vessel: Rt. 23 – Powell River		\$40.0
New INTERMEDIATE Vessel: Rt. 5a – Bowen, Mayne to 9A		\$40.0
New INTERMEDIATE Vessel: Rt. 6 – Howe Sound		\$40.0
New INTERMEDIATE Vessel: Rt. 21 – Quinitsa**		\$17.0
New INTERMEDIATE Vessel: Rt. 9a – Mayne**		\$17.0
	<u>\$288.0</u>	<u>\$218.0</u>

Minor Routes (Rte Grp 4)

Total Ships	<u>PT2</u>	<u>PT3</u>	<u>PT4</u>	<u>Total</u>
	\$69.0	\$288.0	\$218.4	\$575.4
Total Terminals	<u>\$ 2.0</u>	<u>\$109.2</u>	<u>\$ 27.0</u>	<u>\$138.2</u>
Total Rte Grp 4	<u>\$71.0</u>	<u>\$397.2</u>	<u>\$245.4</u>	<u>\$713.6</u>

Route 3 (Rte Grp 2)

Major Vessel Replacement (Coquitlam)	<u>PT2</u>	<u>PT3</u>	<u>PT4</u>	<u>Total</u>
			\$150.0	\$150.0
Terminal Upgrades	<u>\$5.5</u>	<u>\$48.6</u>	<u>\$ 2.7</u>	<u>\$ 56.8</u>
Total Rte Grp 2	<u>\$5.5</u>	<u>\$48.6</u>	<u>\$152.7</u>	<u>\$206.8</u>

Grand Total, Rte Grps 2 and 4

\$76.5 **\$445.8** **\$398.1** **\$920.4**

* Forecast Expenditure also in PT2

** Forecast Expenditure also in PT5

Appendix II

Infrastructure Costs at the end of the Fleet Renewal Program for Minor Routes

Projections for PT2/3/4

We arrive at the following infrastructure costs **at the end of PT4** (completion of ferry fleet renewal program and terminal upgrades)

All amounts in millions of 2007 dollars

	<u>Minor Routes</u>	<u>Route 3</u>
Ships	\$575.4	\$150.0
Amort. per year over 40 y	\$14.4	\$3.8
Terminals	\$138.2	\$ 56.8
Amort. per year over 20 y	<u>\$ 6.9</u>	<u>\$2.8</u>
Total Amortization	\$21.3	\$6.6
Financing per year 6%	\$713.6 \$42.8	\$206.8 \$12.4
Plus current PT1 infrastructure*	<u>\$15.8</u>	<u>\$ 6.0</u>
Infrastructure cost per year	\$79.9	\$25.0
Basic Ferry Service Fee and Federal Subsidy, per year *	\$89.9	\$ 6.4
Annual Operating earnings (loss) *	(\$65.0)	\$ 2.5
Amount avail for capital contribution (Gov't contrib + earnings (loss))	\$24.9	\$ 8.9
Annual Capital Shortfall by PT5 (annual infrastructure cost less amt available for capital contrib.)	\$55.0	\$16.1

Same as for the Northern Routes, the infrastructure costs will increase over time, caused by individual replacements of ships and upgrades of terminals, with both being impacted by inflation.

* data from BCFerries 2007 Route Financial Report

Appendix III

PT1 First Four Years Infrastructure Costs and Ferry Service Fees

All amounts in millions of 2007 dollars

	<u>Minors</u>	<u>Rte. 3</u>
Infrastructure Costs * (amortization and financing)		
2007	\$15.8	\$6.0
2006	\$15.8	\$6.6
2005	\$15.0	\$4.8
2004	<u>\$17.7</u>	<u>\$5.2</u>
Total	\$64.3	\$22.6
Basic Ferry Service Fees *		
2007	\$69.5	\$5.0
2006	\$69.5	\$5.0
2005	\$69.5	\$5.0
2004	<u>\$69.5</u>	<u>\$5.0</u>
Total	\$278.0	\$20.0

During the first four years of PT1 MoT did pay the full infrastructure costs for the Minor Routes and paid \$213.7M (\$278.0M less \$64.3M) towards Operating Expenses.

For Route 3 the infrastructure costs were \$2.6M higher than the Ferry Services Fees paid by MoT.

* data from BCFerries Route Financial Reports