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## 7 Urban transport

### Key points

- The performances of five urban transport government trading enterprises (GTEs) are presented in this chapter. Together they controlled assets valued at \$5.2 billion and generated \$1.6 billion of total income in 2006-07.
- Overall, the profit before tax of urban transport GTEs increased by \$76.3 million in real terms to \$59.6 million in 2006-07. Within the sector:
  - most of the increase in profit before tax was attributable to two GTEs — Public Transport Authority and Sydney Ferries Corporation
  - profit (in real terms) decreased for two GTEs
  - one GTE recorded a loss before tax.
- Return on assets improved from 2.4 per cent to 2.9 per cent in 2006-07. However, all of the monitored GTEs failed to earn a risk-free rate of return.
- Debt to assets for the sector decreased from 46.3 per cent to 22.4 per cent in 2006-07. All urban transport GTEs operated with debt.
- Only TransAdelaide made dividend payments to its owner-government, totalling \$5.3 million. The sector recorded an income tax-equivalent expense of \$607 000 in 2006-07.
- Two urban transport GTEs received community service obligation (CSO) funding totalling \$45.7 million in 2006-07. CSO payments comprised 2.8 per cent of sector income.

The financial performances of five urban transport government trading enterprises (GTEs) are reported in this chapter. Together they controlled \$5.2 billion in assets and generated around \$1.6 billion in income in 2006-07.

Financial performance summaries, including performance indicators for each urban transport GTE monitored over the period 2004-05 to 2006-07 are presented after this introduction. Their financial performances are examined using the financial indicators defined in chapter 1.

There are some differences between measured performance for 2004-05 and 2005-06 in this and earlier reports because of changes in accounting standards, data sources and indicators (chapter 1). Further, the set of monitored GTEs can change

over time because of restructuring and privatisation. Consequently, care should be exercised in making performance comparisons over longer time periods than that covered in this report.

When making comparisons between GTEs, consideration should be given to: differences in the nature and scale of their businesses; their individual market environments; a number of issues relating to the valuation of their assets; and the level of payments for community service obligations (CSOs).

## 7.1 Monitored GTEs

The monitored GTEs vary in their size, corporate structure, and in the range of services they provide. The primary activities of most urban transport GTEs are the provision of bus and ferry services (table 7.1). TransAdelaide and the WA Public Transport Authority (PTA) are also responsible for providing rail services.

Queensland Rail and the Victorian V/Line Passenger Corporation also provide urban transport services as part of their broader rail operations. The performance of these two GTEs is reported in chapter 8.

Total assets controlled by the monitored urban transport GTEs grew by \$278 million (5.7 per cent) in real terms between 2005-06 and 2006-07 (figure 7.1). Most of the growth was attributable to PTA, which increased its total assets by 10.0 per cent in real terms, mainly because of capital investment and revaluations of existing assets. Total assets held by Metro Tasmania (Metro) and State Transit Authority (STA) also grew by 2.1 per cent and 0.8 per cent respectively.

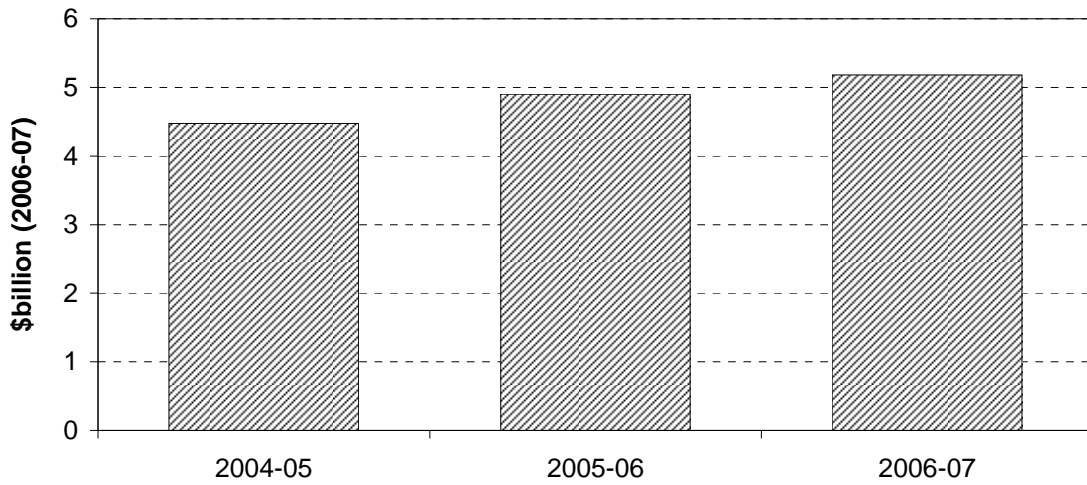
Table 7.1 **Activities — monitored urban transport GTEs, 2006-07**

|   | <i>State</i> | <i>Bus</i>     | <i>Ferry</i> | <i>Tram</i> | <i>Train</i> |
|---|--------------|----------------|--------------|-------------|--------------|
| State Transit Authority                 | NSW          | ✓              | ✓            | x           | x            |
| Sydney Ferries Corporation              | NSW          | x              | ✓            | x           | x            |
| Public Transport Authority <sup>a</sup> | WA           | ✓              | ✓            | x           | ✓            |
| TransAdelaide <sup>b</sup>              | SA           | x <sup>c</sup> | x            | ✓           | ✓            |
| Metro Tasmania                          | Tas          | ✓              | x            | x           | x            |

<sup>a</sup> In addition to its passenger transport activities, the Public Transport Authority is responsible for managing rail infrastructure in Western Australia, principally through its New MetroRail. <sup>b</sup> In addition to its passenger transport activities, TransAdelaide is the infrastructure manager for the Adelaide metropolitan rail network.

<sup>c</sup> TransAdelaide does not operate bus services in its own right. However, it has a joint-venture operation that provides bus services in the Adelaide Hills.

Figure 7.1 Sector assets — urban transport GTEs<sup>a</sup>

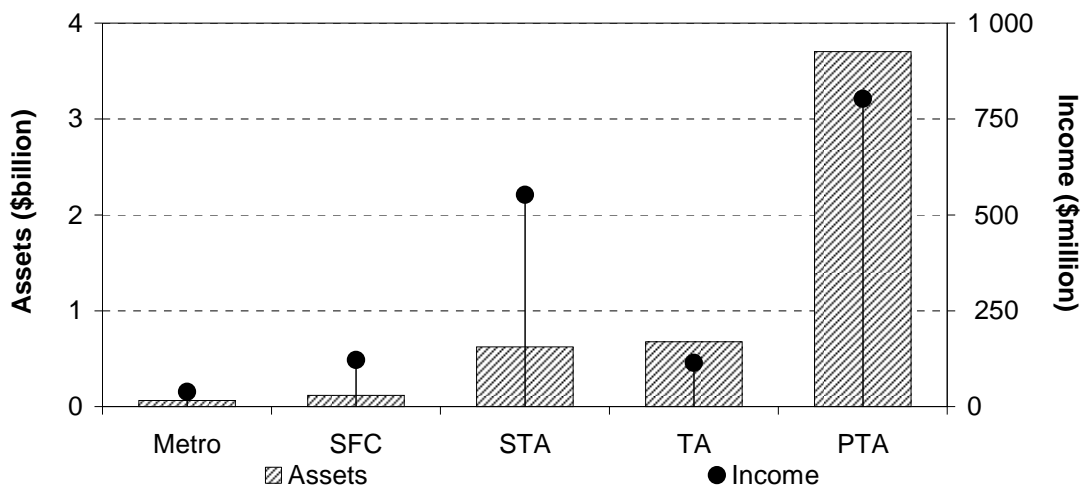


<sup>a</sup> The value of sector assets is reported in 2006-07 dollars using the ABS implicit price deflator — gross fixed capital formation for public corporations (chapter 1).

Source: Productivity Commission estimates.

The relative size of monitored urban transport GTEs (measured in terms of assets and total income) is shown in figure 7.2. PTA is the largest urban transport GTE, accounting for 71.5 per cent of total urban transport assets and 49.3 per cent of sector income in 2006-07.

Figure 7.2 Assets and total income — urban transport GTEs, 2006-07



Source: Productivity Commission estimates.

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## 7.2 Market environment

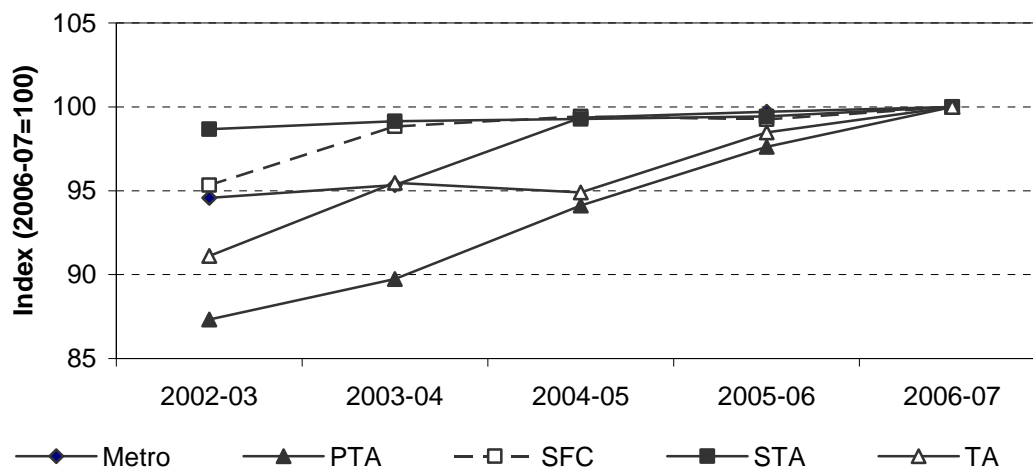
The financial performances of urban transport GTEs are affected by the market environment in which they operate. The demand for passenger services depends on a number of factors, including quality of service, competition from private operators of urban transport, consumer income, the cost of alternative methods of transport (including those associated with driving and parking privately-owned motor vehicles), as well as the level of fares and urban demographics.

### Patronage

Patronage growth was steady or increasing for urban transport in 2006-07, representing a continuation of the increasing patronage observed in 2005-06 (figure 7.3). PTA, TransAdelaide, Sydney Ferries Corporation (SFC) and STA recorded growth in patronage of 2.4 per cent, 1.5 per cent, 0.7 per cent and 0.6 per cent respectively. Metro recorded steady passenger trip numbers of 10.1 million in 2006-07.

For each GTE, patronage growth varied between passenger types and modes of travel. For example, STA reported patronage growth of 13.1 per cent on its Liverpool–Parramatta T-Way network, while patronage of its Newcastle bus and ferry services declined by 0.8 per cent. TransAdelaide noted that its tram patronage grew by 14.0 per cent, but its train passenger numbers fell by 0.7 per cent. Metro

Figure 7.3 Passenger trip trends — urban transport GTEs



Sources: Metro (2007); PTA (2007); SFC (2007); STA (2007); TA (2007); TTF (2007).

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reported a 0.5 per cent increase in urban patronage and a 2.7 per cent decrease in regional patronage (although Metro attributes this to the sale of the Richmond service in February 2007).

## **Regulatory and structural arrangements**

Institutional and regulatory reform has been aimed at reducing the reliance of service providers on government subsidies by commercialising services. It has also focused on promoting efficiency by exposing service providers to more competitive markets (PC 2005c). The principal areas of reform in urban transport have been in supplier market competition and the setting of fares.

### *Market competition*

Some aspects of the National Competition Policy reforms have had an impact on administrative and operational arrangements in the urban transport sector. These include the application of competitive neutrality principles, the contracting out of some services and, from 2005-06, the use of funding contracts to provide performance incentives.

Competitive tendering arrangements have been introduced to provide incentives for improved commercial performance. Urban transport GTEs have been required to compete with private-sector providers for the right to operate certain urban passenger services in South Australia, New South Wales and Victoria.

Since 1995-96, TransAdelaide has been required to compete with the private sector on the basis of a set of costing rules designed to ensure competitive neutrality. TransAdelaide ceased providing bus services after it was unsuccessful in tendering for service contracts with the Passenger Transport Board (PTB) on 22 April 2000. However, it continues to participate in a joint venture with Australian Transit Enterprises to operate bus services in the Adelaide Hills.

State Transit Authority expanded its bus services in Western Sydney after winning a tender to deliver high frequency services along the Liverpool–Parramatta T-Way. STA was awarded the contract in January 2002 ahead of competition from Australian and multinational companies. Services commenced under the new contract in February 2003.

State Transit Authority has made the transition to contract-based funding over the past three years. Four metropolitan bus contracts were signed in 2005-06, followed by a fifth relating to Newcastle buses in 2006-07. According to STA's annual

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report, the funding provided under the new contract will eliminate cross-subsidisation from other STA services to the Newcastle bus services.

The new system of contract-based funding includes payments for achieving certain performance and patronage levels. For example, STA received an incentive payment of \$1.5 million in 2006-07, for exceeding fare revenue benchmarks.

### *Fares*

Prices for the services provided by urban transport GTEs are determined by either the responsible minister or the regulatory authority, namely:

- South Australia — Minister for Transport, Energy and Infrastructure<sup>1</sup>
- New South Wales — Independent Pricing and Regulatory Tribunal
- Western Australia — Minister for Planning and Infrastructure
- Tasmania — Minister for Infrastructure, Energy and Resources, after considering reports by the Government Prices Oversight Commission.

Prices were increased by STA, SFC, PTA and Metro in 2006-07. Fare increases varied between GTEs and ticket types. Increases were restricted to the CPI for PTA, while SFC was allowed an increase of 3.9 per cent. Metro restructured adult fares, resulting in an increase in some fares. Student prices remained at their previous levels for both Metro and PTA.

## **7.3 Profitability**

Profitability indicators provide information on how GTEs are using the assets vested in them by owner-governments to generate earnings.

Four of the five urban transport GTEs recorded a profit before tax in 2006-07. STA, PTA and Metro improved their profitability from 2005-06 to 2006-07.<sup>2</sup> On the other hand, TransAdelaide's profit before tax fell by \$16.0 million in real terms from 2005-06.<sup>3</sup> SFC made losses each year from 2004-05 to 2006-07. SFC's loss declined from \$57.2 million in 2005-06 (2006-07 dollars) to \$5.0 million in

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<sup>1</sup> Prices were determined by PTB until its abolition at the end of December 2003.

<sup>2</sup> Public Transport Authority's higher profit was due to an increase of \$100 million in funding from the WA Government in 2006-07.

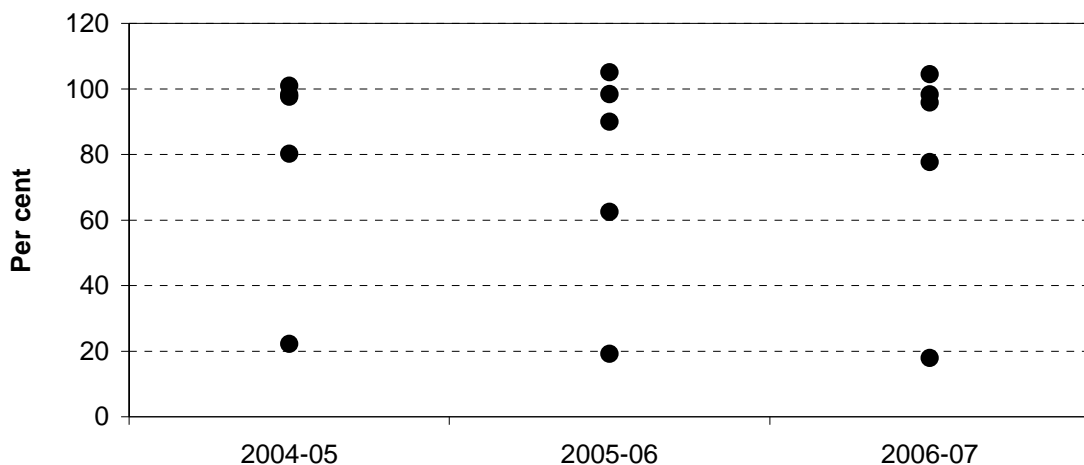
<sup>3</sup> The positive profit before tax in 2005-06 was attributed to the recognition of \$24.6 million in capital grant income related to the sale of tram infrastructure assets.

2006-07, in part due to receiving an additional \$27.0 million government grant.<sup>4</sup> This additional funding provided for safety improvements and short-term debt reduction.

Most urban transport GTEs did not fully recover their operating costs in any year in the period 2004-05 to 2006-07 (figure 7.4). That is, their revenue from operations was insufficient to meet expenses from operations.<sup>5</sup>

State Transit Authority was the only GTE in this sector to record a cost recovery ratio greater than 100 per cent in any of the three financial years. PTA had the lowest level of cost recovery, 17.9 per cent in 2006-07 (down from 19.1 per cent in 2005-06). Despite this, PTA recorded a positive profit before tax because most of its revenue comes from the WA Government in the form of grants and service appropriations. Self-generated revenue from operations contributed only 15.6 per cent of its total income in 2006-07.

Figure 7.4 **Cost recovery — urban transport GTEs<sup>a</sup>**



<sup>a</sup> Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations (chapter 1).

Source: Productivity Commission estimates.

<sup>4</sup> Sydney Ferries Corporation notes in its 2005-06 annual report that the operating loss was largely the result of a fleet devaluation of \$35.8 million to revalue the fleet at current depreciated replacement cost.

<sup>5</sup> With a cost recovery ratio of less than 100 per cent, GTEs can still record a profit because of revenue and expense items other than revenue and expenses from operations. Definitions of these measures are provided in chapter 1.

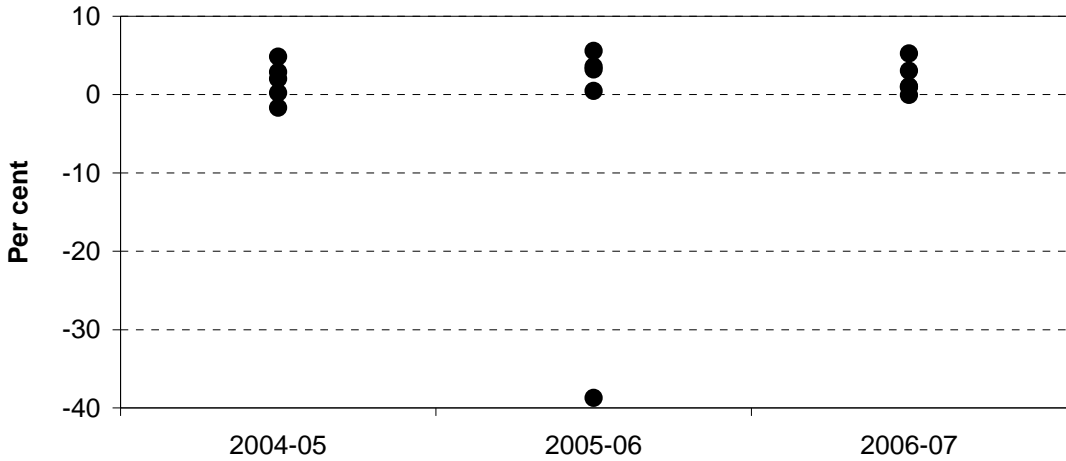
Four of the five urban transport GTEs recorded a positive return on assets in 2006-07, the same number (and the same GTEs) that did so in 2005-06 (figure 7.5).

However, all of the urban transport GTEs had a return on assets that was less than the risk-free rate of return.<sup>6</sup> The highest rate of return on assets recorded over the past three years was by STA (5.5 per cent in 2005-06). SFC had negative returns on assets in 2005-06 and 2006-07 (-38.8 per cent and -0.1 per cent respectively).

This suggests that the operations of urban transport GTEs might not be commercially sustainable at current levels of performance. For example, an urban transport GTE that does not achieve a commercial rate of return might be unable to adequately invest in, or maintain, its capital assets (chapter 4).

Governments might not require a commercial rate of return from urban transport GTEs because urban transport provides external benefits not captured on the balance sheet. Examples include reductions in road user cost, environmental benefits and access for the young, elderly and poor. However, the approach of not explicitly funding CSOs is inconsistent with the commercialisation model, the central focus of the reform process.

**Figure 7.5 Return on assets — urban transport GTEs<sup>a</sup>**



<sup>a</sup> Each data point represents return on assets for a government trading enterprise in that financial year. Return on assets is the ratio of earnings before interest and tax to average operating assets (chapter 1). Average operating assets is the average of the value of operating assets at the beginning and end of each financial year. Where an average could not be calculated, the value of operating assets at the end of the financial year was used.

Source: Productivity Commission estimates.

<sup>6</sup> The risk-free rate of return is defined as the 2006-07 interest rate on 10-year Australian Government bonds of 5.8 per cent (RBA 2008).

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Alternatively, governments could believe that there is scope for further efficiency gains within the GTEs and set prices to reflect the efficient cost of service provision. In that case, low returns would be indicative of inefficient operations.

Return on assets is influenced by a wide range of factors, including changes in revenue and expenses, and changes in asset values — through asset transfers, sale and lease-buy-back arrangements, asset revaluations, asset disposals and depreciation.

Return on equity — the GTE's operating earnings for the year before interest and after tax expressed as a proportion of equity held in the business — tends to move broadly in line with return on assets. However, it is affected by changes in the value of liabilities as well as in the value of total assets.

Only STA achieved a positive return on equity in 2006-07 (9.0 per cent), the same outcome as in 2005-06. TransAdelaide and Metro reported returns of -0.9 per cent and -2.7 per cent respectively, while SFC and PTA reported returns of -71.1 per cent and -32.6 per cent respectively.

## **7.4 Financial management**

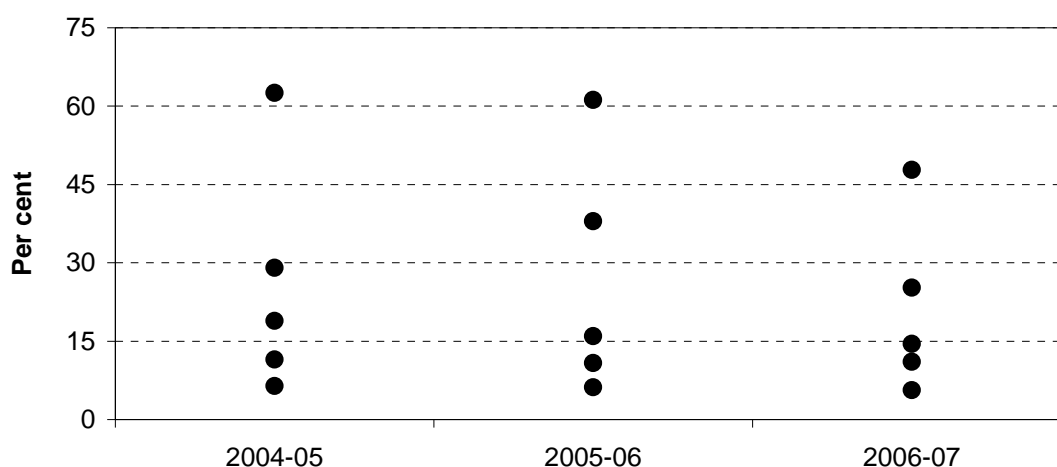
Financial management indicators provide information about the capital structure of a GTE and its ability to meet the cost of servicing debt and other liabilities as they fall due.

Most of the urban transport GTEs had a relatively low level of borrowings in 2006-07. Three out of the five had debt to assets of less than 15.0 per cent (figure 7.6).

The debt to assets of three of the five urban transport GTEs decreased in 2006-07. The exceptions were TransAdelaide (increased to 11.1 per cent in 2006-07) and SFC (increased to 47.8 per cent in 2006-07). In the case of STA, its debt to assets decreased, despite a steady level of borrowing, because of an increase in its total assets.

Sound financial management requires that profits are sufficient to ensure interest payments can be met. A high level of interest cover — the ratio of earnings before interest and tax to gross interest — indicates that a GTE can sustain a fall in profit or an increase in interest expenses and still meet the cost of servicing debt.

Figure 7.6 Debt to assets — urban transport GTEs<sup>a</sup>



<sup>a</sup> Each data point represents debt to assets for a government trading enterprise in that financial year. Debt is defined to include all interest-bearing liabilities (chapter 1).

Source: Productivity Commission estimates.

The interest cover levels reported by urban transport GTEs ranged from slightly negative to 4.9 times in 2006-07. This was an improvement from 2005-06, when interest cover levels were between -12.5 times and 4.5 times.

Sydney Ferries Corporation had negative interest cover in 2006-07, while PTA and TransAdelaide had interest cover of less than two times. This indicates that these GTEs might have to fund interest expenses from sources other than current profits. STA and Metro are likely to be able to meet their interest commitments from operating profit, particularly STA, which improved its interest cover from 4.5 times in 2005-06 to 4.9 times in 2006-07.

## 7.5 Transactions with government

As part of the reform process, governments have sought to facilitate competitive neutrality by giving GTEs a greater commercial focus and exposing them to capital market disciplines. Governments have also focused on ensuring greater competition, by implementing regulations similar to those faced by private-sector businesses.

All monitored urban transport GTEs except PTA and SFC are required to make income tax-equivalent, dividend and debt guarantee fee payments. This is designed to achieve competitive neutrality with private-sector businesses. PTA, as an on-budget agency, is exempt from making both income tax-equivalent and dividend payments to the WA Government. SFC is excluded from making dividend

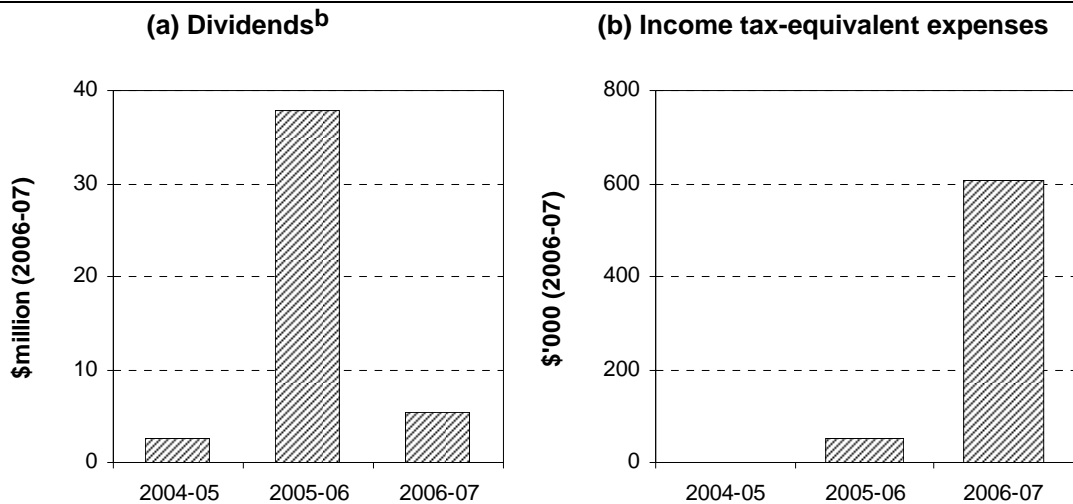
payments under the *NSW Transport Administration Act 1988*. SFC was also exempt from income tax-equivalent expenses in the reporting period.

Dividend payments and income tax-equivalent expenses recorded by urban transport GTEs have been low and infrequent compared with GTEs in other sectors, reflecting the small and volatile returns of these GTEs.

TransAdelaide was the only urban transport GTE to make dividend payments in the period 2004-05 to 2006-07 (figure 7.7). These payments were mainly special dividends, including \$2.3 million for depreciation funding in each of the three financial years. It also included payments of \$32.5 million and \$1.4 million to the SA Department of Transport, Energy and Infrastructure for the sale of tram infrastructure assets in 2005-06 and 2006-07 respectively. The 2006-07 dividend also included \$0.7 million relating to the sale of land and an ordinary dividend of \$1.0 million.

Metro and TransAdelaide recorded income tax-equivalent expenses in 2006-07 of \$0.1 million and \$0.5 million respectively. None of the other urban transport GTEs recorded an income tax-equivalent expense in the period 2004-05 to 2006-07, because of operating losses or accumulated tax losses.

**Figure 7.7 Dividends and income tax-equivalent expenses — urban transport GTEs<sup>a,b</sup>**



<sup>a</sup> The values of dividends and income tax-equivalent expenses are reported in 2006-07 dollars using the ABS implicit price deflator — gross fixed capital formation for public corporations (chapter 1). <sup>b</sup> Data relate to TransAdelaide, the only urban transport government trading enterprise to have made dividend payments in the period 2004-05 to 2006-07. The large increase in dividends in 2005-06 reflects special dividend payments of \$34.8 million. This consisted of \$32.5 million for the sale of tram infrastructure assets to the SA Department of Transport, Energy and Infrastructure and \$2.3 million for depreciation funding.

Source: Productivity Commission estimates.

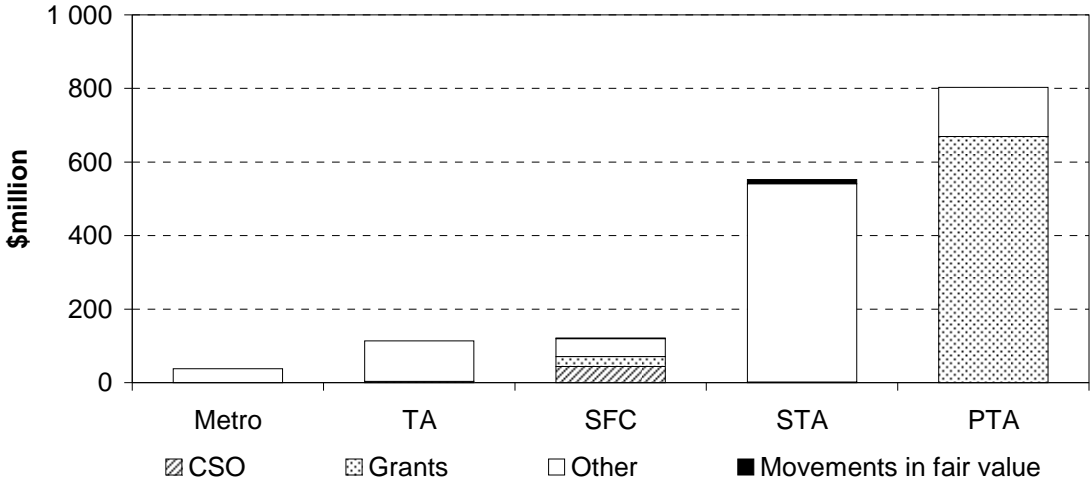
Traditionally, the social benefits associated with the provision of low-cost urban transport services were recognised implicitly by governments. They were paid for by funding operating deficits and the provision of CSOs.

Governments have entered into CSO contracts with their respective urban transport GTEs. CSO contracts across urban transport GTEs include:

- *Pricing* — to reimburse GTEs for offering fares below commercial rates. The government pays the difference between the full fare applicable for the journey and the fare paid by the traveller.
- *Service* — to reimburse GTEs for providing non-commercial services, such as off-peak services with low patronage.
- *Concessions* — to reimburse GTEs for administering government determined concessions. These include the provision of free and concession travel for school students, tertiary students, pensioners and senior citizens, people with disabilities and welfare recipients.

Metro, STA and SFC receive CSO payments. However, Metro does not reveal the value of this funding in its published financial statements. CSO funding accounted for 36.3 per cent of total income for SFC (figure 7.8). However, CSO payments accounted for less than 1.0 per cent of total income for STA in 2006-07 because of its 2005-06 transition to contract payments. These contract payments replaced most of STA’s previous Pricing and Service CSO funding as well as its concession payments for free school travel. The contract payments are not disclosed in STA’s published financial statements.

**Figure 7.8 Income sources — urban transport GTEs, 2006-07**



Source: Productivity Commission estimates.

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As an on-budget agency, PTA does not receive CSO funding as such. However, it receives a large proportion of its revenue from the WA Government in the form of grants and service appropriations.

Government grants account for a relatively large share of total income (figure 7.8) for some urban transport GTEs. Excluding CSOs, PTA and SFC had grants to revenue ratios of 83.3 per cent and 22.6 per cent respectively in 2006-07. TransAdelaide also receives government grants, including capital grants which are amortised over the life of the capital. TransAdelaide had a grants to revenue ratio of 2.9 per cent in 2006-07.

The urban transport sector as a whole had a grants to revenue ratio of 43.3 per cent, which is high in comparison with the other sectors discussed in this report.

## URBAN TRANSPORT

Table 7.2 Whole of sector performance indicators, 2004-05 to 2006-07<sup>a</sup>

| Indicators                                   | Units  | Pre-AIFRS <sup>b,c</sup> |         | AIFRS <sup>b</sup>  |         |
|--|--------|--------------------------|---------|---------------------|---------|
|  |        | 2004-05 <sup>c</sup>     | 2004-05 | 2005-06             | 2006-07 |
| <i>Size</i>                                  |        |                          |         |                     |         |
| Total assets                                 | \$m    | 3 942                    | 4 038   | 4 505               | 5 180   |
| Total income                                 | \$m    | 1 364                    | 1 344   | 1 513               | 1 628   |
| <i>Profitability</i>                         |        |                          |         |                     |         |
| Profit before tax                            | \$'000 | 51 232                   | 22 186  | -15 318             | 59 649  |
| Operating profit margin                      | %      | -49.1                    | -51.6   | -60.4               | -65.3   |
| Cost recovery                                | %      | 67.1                     | 66.0    | 62.3                | 60.5    |
| Return on assets                             | %      | 3.9                      | 3.2     | 2.4                 | 2.9     |
| Return on total equity                       | %      | -27.7                    | -29.0   | -31.6               | -22.2   |
| Return on operating equity <sup>d</sup>      | %      | -27.9                    | -29.9   | -32.2               | -22.3   |
| <i>Financial management</i>                  |        |                          |         |                     |         |
| Debt to equity                               | %      | 125.0                    | 128.6   | 104.7               | 31.2    |
| Debt to assets                               | %      | 46.2                     | 46.2    | 46.3                | 22.4    |
| Total liabilities to equity                  | %      | 172.4                    | 180.3   | 142.7               | 52.1    |
| Operating liabilities to equity <sup>e</sup> | %      | 170.3                    | 178.2   | 140.5               | 49.7    |
| Interest cover                               | times  | 1.5                      | 1.2     | 0.9                 | 1.8     |
| Current ratio                                | %      | 18.4                     | 17.4    | 8.0                 | 34.4    |
| Leverage ratio                               | %      | 270.3                    | 278.2   | 240.5               | 149.7   |
| <i>Payments to and from government</i>       |        |                          |         |                     |         |
| Dividends                                    | \$'000 | 2 296                    | 2 296   | 34 757 <sup>f</sup> | 5 296   |
| Dividend to equity ratio                     | %      | 0.2                      | 0.2     | 2.1                 | 0.2     |
| Dividend payout ratio                        | %      | ..                       | ..      | ..                  | ..      |
| Income tax expense                           | \$'000 | 3 239                    | –       | 46                  | 607     |
| Grants revenue ratio                         | %      | 37.5                     | 37.1    | 40.5                | 43.3    |
| CSO funding                                  | \$'000 | 275 342                  | 275 342 | 68 021              | 45 655  |

<sup>a</sup> Figures are nominal values. <sup>b</sup> Urban transport GTEs commenced reporting under the Australian-equivalent International Financial Reporting Standards (AIFRS) on 30 June 2006. The implications of the transition to AIFRS were discussed in the *Financial Performance of Government Trading Enterprises 2000-01 to 2004-05* report. Data for 2004-05 are reported on an AIFRS and pre-AIFRS basis to illustrate the effect of the transition for urban transport GTEs. <sup>c</sup> Data for years prior to 2004-05 are available in previous *Financial Performance of Government Trading Enterprises* reports. These data were based on the Government Financial Statistics framework and are not directly comparable with the data reported in this table, which are based on GTE annual reports. <sup>d</sup> Refers to 'return on equity based on operating assets and liabilities'. <sup>e</sup> Refers to 'operating liabilities to equity based on operating assets and liabilities'. <sup>f</sup> The large increase in dividends in 2005-06 reflected special dividend payments of \$34.8 million made by TransAdelaide. This consisted of \$32.5 million for the sale of tram infrastructure assets to the SA Department of Transport, Energy and Infrastructure and \$2.3 million for depreciation funding. .. Not applicable. – Zero or rounded to zero.