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Ferries face perfect storm ~ Patrick Brown

The 2008/09 Annual Report from BC Ferries Services Inc is a clear warning of financial storms ahead. The provincially-owned 'privatized' corporation is running out of cash, has maximized its debt, and has raised its fares to the point where it lost 5% of its customers in the last year. And the price of fuel is rising again.

BC Ferries, formerly a Crown Corporation, was 'privatized' in 2003—a convenient solution for a government facing a billion-dollar expenditure to renew a fleet of aging ships. The plan presented to cabinet at that time anticipated that fare increases approximating the rise in the cost-of-living would provide sufficient revenue to convince commercial lenders and bond-buyers to provide capital to pay for the new ships and recapitalize the company.

The plan also assumed that the province would pay a 'fee for service' annually to the company, but that this fee would not rise over the years; that traffic would rise some 25% by 2018; that the price of fuel would not exceed 41¢ per litre; and that the cost of renewing the fleet would approximate $1 billion. The plan warned that if these assumptions did not pan out, the government could face an additional $billion of debt.

Now, six years later, all these assumptions *have* turned out to be wrong. In addition, a worldwide recession has not spared BC or BCFS.

Blame Past Decisions

As the BCLiberal government demonstrated when they were first elected, it's easy to blame governments past. The first BC Ferries' vessel, *Queen of Tsawwassen*, was recently sold; it was 48-years-old. The sixties and seventies saw a flurry of ferry-building, and so planning for rebuilding the fleet was necessarily on the agenda in the late nineties. The NDP government of the day recapitalized the Crown corporation and also built the Fast Cat ferries, pursuing a strategy of faster cross-strait travel with smaller ships, and at the same time, attempting to kick-start an aluminum shipbuilding industry.

In 2003, the newly elected BCLiberal government immediately sold the fast ferries for far less than they were worth, and then blamed the NDP for a 'loss' of $500 million. No effort was made to utilize them, and today they are still tied up on the North Vancouver waterfront, awaiting someone with imagination.

The government then created an undercapitalized new 'private' company, contracted with it to provide the ferry services at a fixed annual 'fee', and created the Ferry Commission to review its fare increases, not from the customers' point of view, but to ensure that it made enough profit to enable it to borrow money to rebuild the fleet. The new company was to be limited to 'aggregate borrowings' of 85% of its capital.

The Debt

The fleet has now been largely rebuilt, and old ships are being disposed of. The company has floated some $1,090 million in long-term bonds, and borrowed $288 million from a German bank to finance the building, in Germany, of the three new Super-C class ferries and the *Northern Expedition*. The 2008/09 financial statements show that BCFS has now borrowed 83% of its capital; it can now borrow only another $45 million before it reaches the 85% limit.

Its total 'aggregate borrowings' are now $1,534 million; annual interest payments have reached $50 million. Largely as a result of increasing interest payments, the profit for 2008/09 was a mere $9 million, compared to $37 million for the previous year, and $50 million for the year before that. Return on Equity, which has a target of 13.6%, has sunk to 3%.

The conditions attached to the debt require that BCFS restrict a large part of its working capital so that the lenders can be assured that BCFS has enough reserves to make payments when they come due. As a result, BCFS finished the year with only $12 million in unrestricted cash; since it has drawn $18 million from a recently negotiated $156 million bank line of credit, the company is effectively in overdraft.

Fares and Fuel Surcharges

This is despite continual increases in fares over the past six years. In fact, according to figures provided by the Ferry Commission, fares have risen to 138% of 2003 levels on the major routes, and 152% on the minor routes over the past six years. Some fares have risen more, some less, but these are the fare 'cap' figures. (The figures assume that fuel rebates will continue—an unlikely circumstance.)

On top of whopping increases, customers have seen fuel surcharges over the past year—extra charges to cover the increasing cost of marine fuel. Fuel surcharges have been extremely volatile—very high last summer, and quite low this

Island Tides, Box 55, Pender Island, BC, Canada. Phone: 250-629-3660. Fax: 250-629-3838.
Email: islandtides@islandtides.com. Website: http://www.islandtides.com

spring (resulting in the current fuel cost rebate on minor routes). The surcharge is calculated to recover costs over and above the budgeted price of fuel, and to insulate fares from the most extreme variations; the company also, of course, hedges its fuel contracts to try to contain the damage (BCFS states that it does not speculate beyond its needs, however). The company does not release figures on what it is paying for fuel. However, the trend over the longer term is inevitably up.

Traffic—None so Blind...

The 2008/09 report shows that traffic is down over 5% from the previous year. In fact vehicle and passenger traffic is now *less than it was in 2003*—the final year of the Crown corporation.

The company provides a long list of reasons for this: the economy, weather, transportation costs, the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics and population growth.

Interestingly, increased fares is *not included on this list*; in fact the Annual Report says BCFS is 'uncertain' of the effect of fare increases on traffic volumes.

A 2004 bond issue prospectus stated that a 10% increase in fares would result in a less than 7% decrease in demand, and so the company could increase fares and still realize increased revenue. The study of this was confined to major routes, however; the prospectus said that minor routes would show less decrease in demand, since minor route travelers had less choices and fewer of their trips were 'discretionary'. (In other words, as the company has a monopoly, it can raise fares with less effect on traffic.)

Since that time, of course, cumulative increases have been far greater than 10%, and more time has elapsed for customers to make discretionary changes in their long-term travel habits.

It is also important to remember that traffic forecasts in 2003 predicted a 25% increase over 15 years, or at least 1% per year. This is clearly not occurring.

The decline in traffic has had a devastating effect on profits, of course. It is also worth noting that there have been a significant decline in paid reservations and assured loading sales, both clearly discretionary.

FACC calls for Lower Fares Through Better Provincial Support

The Ferry Advisory Committee Chairs (FACC), commenting on the report, furnished a proof of the significance of fares. They noted that last December and January were a 'bright spot for coastal transportation,' when the provincial government allocated an extra $20 million to finance a temporary 33% fare reduction for two months. While traffic was affected by severe weather in December, traffic gains in January (not normally a strong month for discretionary travel) were 2% for passengers and 3% for vehicles. The FACC summed up, 'In the longer term, BCF needs more revenue, ferry users need lower fares, and the BC government has shown that appropriate government backing for ferries can do both.' They called on the provincial government to step up its investment in ferries in order to safeguard public access to British Columbia's coast.

Commentary

It's obvious to 750,000 Island-dwellers on large and small Island, that ferries are an essential part of the provincial highway system.

For the government to have created a quasi-private, underfunded, monopolistic corporation and then to have left it to its own devices is irresponsible government.

We have now arrived at the worst-case model, anticipated in the planning document which predicted the privatizated structure would fail. The government must now intervene on behalf of three-quarters of million Islanders—20% of BCs population. ✐

Patrick Brown thanks Nellie Maxey for her analysis of ferry figures. ✐

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