Proprietary

MINISTRY OF EDUCATION
TE TAHUHU O TE MATAURANGA

Education Report: Additional information on the school transport tender

| To:       | Hon Chris Hipkins  
|           | Minister of Education  
|           | Hon Jenny Salesa  
|           | Associate Minister of Education  
| Date:    | 27 September 2019  
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| METIS No: | 1265844  
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| Round Robin: | Yes / No

Purpose of Report

The purpose of this briefing is to provide you with additional information on the school transport tender, including setting out the implications of your decision not to seek a pre-Budget 2020 commitment for operating contingency funding to improve emissions performance and ensure there is seating for all students.

Recommendation

Note that a briefing and draft Cabinet paper, School bus tender process and requirements, seeking approval for a pre-Budget 2020 commitment for funding for new school transport requirements to improve emissions performance and provide seating for all students, were provided to you on 11 September 2019 [METIS 1204703 refers].

Noted

Note that further advice provided since 11 September includes a briefing dated 16 September, Information regarding contingency funding sought for the school transport tender [METIS 1205844 refers].

Noted

Agree that you will not be seeking a pre-Budget 2020 commitment for funding new school transport requirements through the school transport tender to improve emissions performance and provide seating for all students, and that the Cabinet paper is no longer required.

Agree / Disagree

Note that without a pre-Budget 2020 commitment for funding new school transport requirements to improve emissions performance and provide seating for all students the Ministry of Education will have to remove these requirements from the school transport tender.
Agree that the Ministry will seek to achieve some of the benefits of improved emissions performance and seating of students by using the procurement process and performance regime to encourage, but not require, transport suppliers to tender on the basis of delivering some improved emissions performance and student comfort outcomes.

Note that, despite not requiring improved emissions performance or seating for all students through the procurement process, the overall costs of new school transport contracts may exceed the current appropriation of $110 million per annum, which will be addressed through the baseline update process as is already regularly done for changes in the costs of providing school transport services.

Note s 9(2)(g)(i)

Note that the timeframe for the school transport procurement process needs to be adjusted to ensure the process and all the associated procurement documentation reflects the above decisions.

Note that the Ministry is still finalising the expected timeframes but current indications are that a Request for Proposal could be released in late October 2019; Proposals close late December 2019; Contracts Awarded May 2020; New contracted services begin in February 2021.

Agree that this briefing will not be proactively released at this time because it relates to matters that are commercially sensitive.

Kim Shannon  
Head of Education Infrastructure Service  
2/9/19

Hon Chris Hipkins  
Minister of Education  
2/9/19

Hon Jenny Salesa  
Associate Minister of Education  
__/__/
Background

1. The Ministry of Education (the Ministry) offers transport assistance to students who do not have access to public transport and where distance from their closest school is a barrier to education.

2. The current contracts for Daily Bus and Technology Bus services expire on 31 December 2020 with no right of renewal. The Ministry has an appropriation of $110 million per annum to cover the current costs of Daily Bus and Technology Bus services. The Ministry has started a procurement process for new contracts for Daily Bus and Technology Bus services. It will result in contracts valued in excess of $1 billion over 12 years (based on current levels of service).

3. We provided you with a briefing and draft Cabinet paper School bus tender process and requirements [METIS 1204703 refers] on 11 September. The draft Cabinet paper:
   - Informed Cabinet of the process and seeks its agreement to new requirements for the upcoming tender process;
   - Outlined the timing and decision points for the procurement process, and
   - Sought agreement to a pre-commitment to Budget 2020 for an operating contingency of $9(2)(g)(i) over four years for estimated funding needed for the new contracted services.

4. Awarding contracts in early 2020 is a key milestone of the procurement process so that operators have sufficient time to prepare for the new contracts that start at the beginning of the 2021 school year. The timing of the Budget 2020 process would not have provided the Ministry with certainty on funding bids in time to initiate the procurement process in good faith, so a pre-commitment to Budget 2020 needed to be sought. The Treasury confirmed that a pre-commitment against Budget 2020 would be required given the procurement timeframes.

5. Following a meeting of Ministers on Tuesday 24 September, the Ministry was advised that a Budget 2020 pre-commitment would not be sought.

6. This briefing sets out the implications of your decision not to seek a Budget 2020 pre-commitment and outlines Ministry advice on how to achieve some of the high level outcomes without explicit requirements in the procurement process. The briefing also provides further information that was requested on the costs and scaling options for the funding the Ministry was seeking as a pre-commitment to Budget 2020, and information on the last (2007/08) school transport tender process.

Implications of not seeking a Budget 2020 pre-commitment to fund improvements in emissions performance and ensuring seating for all students

7. Without a pre-Budget 2020 commitment for funding new school transport requirements to improve emissions performance and provide seating for all students, the Ministry will have to remove these explicit, mandatory requirements from the services sought through the school transport procurement process.

8. $9(2)(g)(i)$
9. To achieve some of the benefits of improved emissions performance and seating of students, the Ministry proposes to use the procurement process and performance regime to encourage transport suppliers to tender on the basis of delivering improved emissions performance through younger vehicles and better student comfort outcomes. This will require a careful balancing of the value of benefits of any encouragements with the additional costs of services.

10. The Ministry will need to be careful to ensure that we do not remove explicit mandatory requirements for younger vehicles and seating for all students, but end up effectively requiring and paying for these measures by the encouragements in the procurement process and performance regime being too strong.

11. Removal of the requirement to have a younger vehicle fleet to improve emissions performance does have some potential benefits. Potential benefits include lessening the barriers for some transport suppliers with older fleets and reducing the risks of service disruptions due to lack of suitable vehicles in 2021.

12. The proposed lower vehicle age requirements were likely to be more difficult for some of the smaller local and regional transport suppliers to meet. This is because in most cases, but not all, the Ministry’s smallest providers operate the oldest vehicles. The costs of purchasing newer vehicles were also likely to be higher for smaller operators due to the superior purchasing power of larger suppliers. The removal of requirements for lower vehicle ages may mean there is a greater ability for those smaller suppliers to successfully compete in the procurement process. Because the Ministry is moving from tendering for individual bus routes to groups of routes, smaller suppliers may still have to look to expand their operations significantly or consider working with other suppliers in order to be able to tender for a group, or groups, of bus routes. The removal of vehicle age requirements will lessen, but not eliminate, the difficulties many smaller suppliers will face in successfully tendering for groups of school bus routes through this procurement.

13. Removal of the proposed lower vehicle age requirements will also mean that the risks of disrupted services in 2021 are lowered. A significant risk under the lower vehicle age proposal was that suppliers would not be able to procure sufficient numbers of vehicles of the appropriate ages by the start of the 2021 school year. By removing the vehicle age requirement the risk of disruption to service on the basis of vehicle availability will be virtually eliminated. The Ministry had planned to provide suppliers with additional transition time to manage this risk, which will not be required now.

14. Decisions on the service requirements to include in the school transport procurement process will be in effect for a significant period of time. The school transport contracts the Ministry will enter into following the procurement process will be for an initial term of six years (i.e. from 2021 to 2026 inclusive), and there are two additional three year terms that can be renewed (i.e. from 2027 to 2032 inclusive). The length of contract is required to give transport suppliers certainty and a sufficient period to generate returns on what can be significant investments into vehicles to deliver these services.

15. Outside of poor performance by suppliers, the Ministry will have limited ability to exit these contracts. The Ministry does have the ability, at any time, to propose to vary the requirements of contracts, and this could include variations to require seating for all students, or to reduce vehicle ages to improve emissions performance. However, variations can only be progressed if there is mutual agreement between the Ministry and suppliers. Transport suppliers will expect any variations that result in increasing their costs to be at least matched by the Ministry agreeing to pay higher prices for their contracted services. Experience suggests that variations occurring within an existing
contract term generally result in suppliers requiring higher price increases than if new requirements are established as part of a new contract. To pursue any contract variations, the Ministry would need to have the relevant funding approvals in place.

16. The Ministry does not know exactly how much the new school transport services will cost, regardless of whether or not requirements for improved emissions performance and seating are included. The Ministry is running a procurement process and the nature of that process is that the exact costs of services we are seeking will not be known until the process has been completed.

17. The estimates of the costs of measures to improve emissions performance and ensure seating for all students are the Ministry's best estimates of those costs. Removing these requirements is likely to reduce the overall cost of the school transport services the Ministry procures. However, the Ministry cannot guarantee that removing the specific requirements for improved emissions performance and provision of seating, will result in the total cost of the school transport services procured being within the existing $110 million per annum appropriated to cover these services. The overall costs as a result of the procurement process will also be affected by a number of factors not directly linked to requirements specified by the Ministry, including changes to operator costs, profit margins and so on.

18. If the Ministry does not specify or require policy changes to require new school suppliers to deliver improved emissions performance or seating, and the costs of new school transport contracts does exceed the current appropriation of $110 million per annum, additional funding can be sought, and should be approved through the appropriate baseline update process (probably in October 2020). The baseline update process is designed for addressing forecast changes in costs of providing existing services. The Ministry uses the baseline update process for school transport cost increases on a regular basis to ensure we are appropriated for the changes in costs of delivering services. This is an accepted mechanism for addressing cost pressures that arise over the course of long-term contracts. This mechanism would not be appropriate if the Ministry's changes to the procurement process and performance regime effectively require younger vehicles and seating for all students, despite these not being explicit changes in service specifications.

19. The Ministry has, until very recently, been working towards a procurement process that included improving emissions performance through requiring younger vehicles and requiring all eligible students to be seated. These matters are integrated throughout the wide range of documentation associated with a procurement process of this size and scale. The procurement process is one overall process, but involves separate tender processes for the 87 groups of routes across all regions of New Zealand. Through the maximum 12 year term of contracts in this procurement the total value will be well in excess of $1 billion.

20. The Ministry needs to ensure that changes to remove the requirements to improve emissions performance and seating for students are done correctly and comprehensively. The Ministry will also need to consider and determine the exact details of how to encourage improved emissions performance and student comfort outcomes through the procurement process without incurring significant cost. This will need to be clearly and accurately communicated to the transport supplier market. These changes will take some time. The Ministry is still working through the time required to make these changes, but it will result in a delay to previously advised procurement timeframes.

21. The Ministry's indicative assessment of the potential key milestones in the procurement process are as outlined in the following table. The Ministry will inform your offices as these timeframes are confirmed. Overall, the Ministry is confident that new school transport suppliers and services will be in place from the start of 2021 and that
there will be a seamless continuity of school transport services that deliver eligible students to and from school safely, reliably and ready to learn.

<table>
<thead>
<tr>
<th>Indicative procurement process milestones</th>
<th>Timing</th>
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<tbody>
<tr>
<td>Release of Request for Proposal</td>
<td>28 October 2019</td>
</tr>
<tr>
<td>Tender submissions close</td>
<td>23 December 2019</td>
</tr>
<tr>
<td>Evaluation of tender submissions</td>
<td>January – April 2020</td>
</tr>
<tr>
<td>Contracts awarded</td>
<td>April-May 2020</td>
</tr>
<tr>
<td>Preparation and transition for new contracted services</td>
<td>May 2020 to January 2021</td>
</tr>
<tr>
<td>New contracted services begin</td>
<td>February 2021</td>
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</tbody>
</table>

Information on the costs and scaling options for the proposed pre-Budget 2020 funding commitment

Description of matters with funding implications

22. You asked for further information on the costs and scaling options for the matters covered by the proposed pre-Budget 2020 commitment of operating contingency funding. This is set out below. The operating contingency being sought related to three matters:

- **Reducing the age of school buses to improve emissions performance**, s 9(2)(a)
  In line with the government’s commitment to support a transition to a net-zero emissions economy the Ministry investigated a range of changes to reduce the maximum age requirements for school buses as a proxy for reducing emissions. A range of different options were considered but reducing the maximum age from 26 years to under 23 years, and introducing a maximum average age of under 15 years, was the only feasible set of requirements New Zealand operators could meet. This option was also estimated to be the cheapest of the different age requirements considered.

- **Ensuring that there is sufficient seating for all eligible students**, s 9(2)(i)
  The Associate Minister of Education agreed in 2018 to a Ministry proposal to cease the practice of standing on Ministry contracted school bus services, following perceived safety concerns raised in the media. The proposal is based on passenger comfort rather than safety. Having all eligible students seated means that they can travel comfortably and arrive at school ready to learn.

- **Increasing costs of providing transport services before new contracts start in 2021**, s 9(2)(i)
  The costs of providing transport services change over time (e.g. fuel, labour) and a New Zealand Transport Agency administered transport index is used to measure movements in these costs. Changes to appropriation due to movements in underlying costs are normally considered and progressed through baseline updates. The Ministry sought to identify estimated increased costs that were likely to be factored into the new contracts by the time they started in 2021 to ensure the total estimated cost of new school transport contracts was known, even though these costs pressures could be approved via baseline update processes.

23. A description of the estimated costs for each of these three matters is set out in Annex One. The costs are only estimates based on the information we have available on the respective matters at this stage. Tender submissions will not breakdown costs to the level of these separate matters and will only provide an overall cost.

24. The Ministry considered, and rejected, having a procurement process that required individual elements of a tender to be priced separately, as it would have introduced significant complexity and cost for suppliers to comply with (especially for smaller suppliers), and would also require additional time and cost for the Ministry to assess
tender proposals, which would extend the overall time required to complete the procurement process.

25. As the Ministry has previously outlined there are limited scaling options:

- **Reducing the age of school buses to improve emissions performance**: The Ministry could remove this requirement from the procurement process and maintain the current maximum vehicle age requirement of less than 26 years.

  A smaller age reduction could be introduced – but we could not confidently estimate what the cost of such an option would be, and cannot quantify the emissions reductions it would achieve.

  The Ministry intends to encourage, rather than require, transport suppliers to tender on the basis of younger vehicles to deliver improved emissions performance. This encouragement will take the form of including, as one of the quality criteria used to evaluate tenders, whether a tender proposal is based on meeting the specified vehicle age requirements (under 26 years old) or if the suppliers’ services will use vehicles with a lower maximum age.

  Suppliers proposing the use of vehicles with a lower maximum vehicle age will be rewarded on that quality criterion in the evaluation process. There are also a number of other quality criteria that are considered in the evaluation process, and tender price is the single most significant evaluation criteria. So this measure will provide some encouragement for tenderers to use younger vehicles and therefore improve emissions performance, but this will be balanced against a range of other factors and the actual outcomes will not be known until the procurement process has been completed.

- **Ensuring that there is sufficient seating for all eligible students**: This matter is a binary scaling choice – either there is a requirement that there is sufficient capacity for all eligible students to be seated, or there is not.

  If the Ministry removed the explicit requirement that all eligible students must be seated, this would be unlikely to result in significant widespread instances of students standing on buses. This is because bus routes for the new school transport contracts have already been designed for a smaller loading capacity than previously, so it is more likely that suppliers will have capacity to seat all students.

  Removing the explicit requirement may not remove all of the associated costs as the redesign of the routes has effectively hardwired the requirement into the system and the prices from suppliers are likely to reflect this.

  To fully remove the requirement for all eligible students to be seated would require the Ministry to redesign all bus routes. This is a lengthy process that would delay the tender process to the extent that new contracted services could not be in place before current contracts expire at the end of 2020. The Ministry would need to establish temporary contracts with operators to provide services until new contracts were in place and this is likely to be even more expensive.

  The best and most cost-effective option is to remove the explicit requirement from the school transport tender process that all eligible students are seated and proceed with the bus routes as redesigned by the Ministry. The Ministry will also look to achieve improved student comfort outcomes by including an appropriate key performance indicator in school transport contracts.

- **Increasing costs of providing transport services before new contracts start in 2021**: This matter was highlighted by the Ministry to provide a complete picture of the likely overall costs of school transport services in 2021.

  No funding is required at this point in time. Any funding that is required due to increases in costs or demand for services to be delivered in 2021 can be sought
through normal baseline update processes. Most likely this will involve a baseline update in October 2020 once costs for services in 2021 are clearer.

Information on the last 2007/08 school bus tender process

26. The last national school bus tender for school bus services was in 2008. Since then there have been multiple small tenders for additional services or as a result of a terminated contract, and national tenders for specific transport services.

27. Prior to the 2008 tender, there were there were 227 suppliers of school bus transport services. 165 potential suppliers started the selection process; 151 of them passed the qualification phase; 146 suppliers submitted pricing bids; and 95 subsequently entered into contracts with the Ministry to provide school bus transport services. The supplier pool has further contracted over time due to market consolidation and changes outside of the Ministry’s influence, with services now being provided by 67 suppliers.

28. The 2008 tender resulted in a significant, i.e. 20%, increase in costs (note this included services tendered for and managed by the Ministry as well as services funded by the Ministry but arranged directly by schools, as a number of services changed from Ministry management to school management around this time).

29. School transport contracts and funding agreements are all based on calendar years, with the new arrangements commencing 1 January 2009. The change is evident over three financial years, 2007/08 “before”, 2008/09 “during”, and 2009/10 “after”:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
</tr>
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<tbody>
<tr>
<td>2007/08</td>
<td>$100,201,232.54</td>
</tr>
<tr>
<td>2008/09</td>
<td>$114,602,874.25</td>
</tr>
<tr>
<td>2009/10</td>
<td>$120,331,611.70</td>
</tr>
</tbody>
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30. There are two key takeouts from the 2008 national school bus tender process that the Ministry believes are relevant for the current procurement process. Firstly that the procurement process heightens the competitive pressures on suppliers and this competitive pressure often results in significant market consolidation i.e. far fewer successful suppliers. Secondly, while it is difficult to accurately compare costs and mixes of services across time, the competitive tension and market consolidation does not automatically correlate to stable or reduced costs and can still mean that overall costs increase.

Next steps

31. The Ministry will confirm its procurement process timeframes and plans for communicating with the market following confirmation of your decisions.

32. There are likely to be some adverse reactions from the transport supplier market to news of the changes, and this could generate negative media attention. Until recently, the Ministry had been signalling to the market that changes to vehicle ages to improve emissions performance, and changes to ensure the provision of seating for all students, would form core requirements of the school transport procurement process. This will no longer be the case. Based on feedback at roadshows the Ministry has undertaken there may be some support for the changes from some transport suppliers. The Ministry will manage all communications carefully and will keep your offices closely informed.

33. To protect the integrity of the ongoing procurement process and to maintain Ministerial independence from the procurement process, we recommend that you direct any enquiries, particularly any enquiries from transport suppliers and industry groups to the Ministry. This will ensure that we can address issues through the official channels that
have been established for the procurement process and that all market participants have access to the same information.

Proactive Release

34. We recommend that this briefing is not proactively released as it relates to matters that are commercially sensitive. The Ministry will release this briefing once final decisions on the school bus tender are made.

Annex 1: Description of the cost estimates for the school transport operating contingency being sought

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Estimated additional cost per annum</th>
<th>Description</th>
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| Reducing vehicle age (as a proxy for improving emissions performance) | s 9(2)(j)                           | To estimate the cost of this initiative the Ministry obtained indicative pricing information from one of the largest bus operators in NZ.  

The operator has high quality pricing models and it provided indicative cost estimates for a range of different vehicle age requirements that the Ministry was considering. The estimate was based on a particular group of routes in a region. The potential cost increases for the different age requirement options ranged from s 9(2)(j) more than current (status quo) costs.  

The estimated cost of the proposed requirements for a maximum age of 23 years and maximum average age of 15 years is up to 15% more than the status quo cost s 9(2)(j). |
| Sufficient seating for eligible students             | s 9(2)(j)                           | This estimate is based on the number of routes that the Ministry is currently running with eligible students standing and the likely costs of increasing bus capacity and designing routes to a smaller maximum loading. |
| Increasing cost pressures                             | s 9(2)(j)                           | The Ministry uses the NZTA’s Diesel Bus Index to measure quarterly movements in the costs of providing transport services (e.g. labour costs, fuel costs). Based on recent index trends, we estimate that costs could increase by s 9(2)(j) by the time contracts commence in 2021 s 9(2)(j).                           |
| Total contingency                                    | s 9(2)(j)                           |                                                                                                                                              |