

## **Item: 12**

**Policy and Resources Committee: 20 February 2018.**

**Responsibility of Orkney's Inter Island Ferry Services.**

**Joint Report by Chief Executive and Executive Director of Development and Infrastructure.**

### **1. Purpose of Report**

To reconsider options in respect of responsibility of Orkney's Inter Island Ferry Services.

### **2. Recommendations**

The Committee is invited to note:

#### **2.1.**

That, on 19 December 2012, Transport Scotland published the Scottish Ferry Services Ferries Plan, setting a way forward for improved services and infrastructure over a 10 year period.

#### **2.2.**

That the Ferries Plan made reference to the potential for some local authority operated lifeline ferry services to transfer to the Scottish Government, as outlined in section 5 of this report.

#### **2.3.**

That excess expenditure incurred by the Council over funding received in support of inter island ferry services has continued to rise.

#### **2.4.**

The comparisons in terms of revenue and capital expenditure levels between Orkney's inter island ferry services and those services which are the direct responsibility of the Scottish Government, as outlined in section 9.4 of this report.

#### **2.5.**

That it is not sustainable for the Council to provide the level of revenue and capital support towards Orkney's inter island ferry services without additional support from Scottish Government.

#### **2.6.**

That, on 28 November 2017, the Policy and Resources Committee recommended that responsibility of Orkney's inter island ferry services be passed to Transport Scotland.

## **2.7.**

That, on 12 December 2017, when considering the recommendation at paragraph 2.6 above, the Council resolved that deliberations on responsibility for Orkney's inter-island ferry services be referred back to the Policy and Resources Committee for further consideration.

## **2.8.**

That, on 31 January 2018, the Scottish Government announced its intention to provide supplemental grant funding, amounting to £5,500,000, to cover the deficit revenue funding gap, for 2018 to 2019, in relation to Orkney's inter island ferry services.

## **2.9.**

That discussions with the Scottish Government will continue regarding long term fair funding for inter island ferry services.

## **2.10.**

That alongside, but separate to, the fair funding discussions referred to at paragraph 2.9 above, it is now necessary to directly consider the principle issue of transfer of responsibility of Orkney's inter island ferry services to the Scottish Government.

**It is recommended:**

## **2.11.**

That the Committee considers the options appraisal, outlined in section 8 of this report, noting that Option 2 represents the most financially prudent option for the long term delivery of Orkney's inter island ferry services in the context of the Scottish Government Ferries Plan and strategic investment commitments.

## **2.12.**

That the principle of the transfer of Orkney's inter island ferry services to the Scottish Government, where this is of no net detriment to the Council, be approved.

## **2.13.**

That powers be delegated to the Chief Executive, in consultation with the Leader, the Head of Finance and the Solicitor to the Council, to agree terms for the transfer of responsibility for Orkney's inter island ferry services to the Scottish Government, where this is of no net detriment to the Council, as soon as possible.

## **3. Policy Aspects**

The proposal outlined in this report supports target 6.2, Orkney's Internal Ferry and Air Services, as outlined in the Council Plan 2013 to 2018.

## **4. Introduction**

Previous decisions of the Council in respect of responsibility for inter-island ferry services are detailed in Appendix 1 to this report.

## **5. Background**

### **5.1.**

The background of transferring responsibility of ferry services to Orkney Islands Council and local authority funding is attached at Appendix 2 to this report.

### **5.2.**

The Scottish Ferry Services Ferries Plan for the period 2013 to 2022, published by Transport Scotland on 14 December 2012, aimed to set a way forward for ferry services in Scotland, recognising the significant contribution ferry services make to the social, cultural and economic wellbeing of Scotland.

### **5.3.**

The purpose of the Scottish Ferries Review was:

- To develop a shared vision and outcomes for lifeline ferry services in Scotland, in the context of the Government's Purpose, Economic Strategy and National Transport Strategy.
- To analyse the current lifeline ferry services and network, identifying how well it meets the proposed outcomes and how it links to the rest of Scotland's transport network.
- To inform the Scottish Government's long-term plan for lifeline ferry services in Scotland and influence the next round of procurement of ferry services.
- To identify policies to be taken forward to deliver the long term plan, including the planned investment work.

### **5.4.**

The Ferries Plan makes recommendations regarding:

- Where investment should be focussed to make improved connections for island and remote rural communities.
- Improving reliability and journey times.
- Seeking to maximise the opportunities for employment, business, leisure and tourism.
- Promoting social inclusion.

### **5.5.**

The Ferries Plan focused significantly on the Clyde and Hebrides routes, including future revenue and capital investment, which are the responsibility of Transport Scotland, compared with life line ferry services operated by Local Authorities.

## **5.6.**

The Ferries Plan notes that ‘the services within the Orkney and Shetland Isles are currently the responsibility of the respective local authorities. The Draft Ferries plan indicated Scottish Government’s intention to discuss these and other Local Authority services with the responsible authority if they wished, and through these discussions determine the future responsibility of the services’.

## **5.7.**

The Ferries Plan outlines that if Scottish Government are asked to take responsibility for Local Authority ferry services, they will require an adjustment to be made to the Scottish Government’s local government block grant, to ensure that they are in receipt of the revenue required to run the services in the future. It notes that a capital transfer may also be required to address issues with ageing vessels, ports and harbours. The principles of transferring responsibility are not however consistent with that already operated by Transport Scotland.

## **5.8.**

Since publication of the Ferries Plan, significant work has been carried out by the Council, Transport Scotland, Highlands and Islands Enterprise and HITRANS in respect of Inter Island ferry services, including the Orkney Islands Ferry Services Routes and Services Methodology, Orkney Outer North Isles Scottish Transport Appraisal Guidance Study and Orkney Inter Island Transport Study Strategic Business Case. Work is now underway to progress with the Outline Business Case to consider a single option for each ferry route. The Outline Business Case will help inform the revenue and capital funding requirements for the medium to long term.

# **6. Joint Working**

## **6.1.**

Since November 2014, Transport Scotland, Orkney Islands Council, HITRANS, Shetland Islands Council and ZetTrans have been working together to progress the Scottish Government’s commitment to reach a fair funding position for Orkney Islands Council and Shetland Islands Council in relation to Inter Island transportation services. More specifically, to deliver upon the political commitments established in the Empowering Scotland’s Islands Communities Prospectus, and the 10 Point Islands Manifesto in relation to fit for purpose, quality ferry services and ensuring that provision of service does not place a disproportionate burden on Councils.

## **6.2.**

The two priorities to be addressed in order to deliver an acceptable outcome for each Council were:

- Priority 1 – securing short term immediate funding to address the disproportionate financial demands historically and currently faced by the Councils in providing Inter Island ferry services.

- Priority 2 – to establish and implement a mutually acceptable long term model of responsibility, delivery, revenue funding and strategic capital investment programme for Inter Island transport services and infrastructure.

### **6.3.**

Discussions over the long term funding of Orkney's Inter Island Air and Ferry Services have followed an evidence based approach as requested by Transport Scotland. Findings have been based upon the Orkney Inter Island Transport Study and Orkney Inter Island Routes and Services Methodology. This work has confirmed that Inter Island ferry services in Orkney are below the Transport Scotland recommended levels, both in terms of frequency and length of operating day, fares are higher than the rest of Scotland, due to the introduction of the Road Equivalent Tariff across the majority of other ferry services and the fact that the vessels are reaching the end of their operating life.

## **7. Fair Funding**

### **7.1.**

Following engagement with the Minister for Transport and the Islands, then Derek Mackay, a Northern Isles Inter Island Transport Fair Funding Working Group was established in April 2016. The short-life working group, involving Scottish Government and Council officers, was established with the view to undertake a process of option development, appraisal and reporting that will establish mutually acceptable solutions that address the short term funding of Inter Island Ferry Services and a long term model of responsibility for, deliver of and funding of Inter Island Transportation Services and infrastructure in Orkney and Shetland.

### **7.2.**

The fair funding process confirmed the priorities outlined at section 6.2 above. A package of data, including ferries profit and loss accounts, fares data, passenger and vehicle carryings and timetables from Orkney and Shetland Islands Councils, was also submitted to Transport Scotland in July 2016 to support the work of the Fair Funding process. Unfortunately, despite initial indications that the matter would be resolved for 2017 to 2018 this was not the case. Further engagement with Transport Scotland and the Scottish Government continued during 2017 with a revised funding proposal being submitted to Transport Scotland in June 2017. It is the understanding of the Council team that Transport Scotland officers have validated this information and that this has been presented as part of the Transport Scotland budget setting proposal for 2018 to 2019.

### **7.3.**

Correspondence from Council Leaders to Scottish Ministers reiterated this point in a joint letter sent on 28 June 2017, which included the refined Joint Statement of Fair Funding Requirements, attached as Appendix 3 to this report. The correspondence to Ministers confirms the consequences of a failure to resolve Fair Funding in time to plan the 2018 to 2019 budget, as ultimately severe and devastating cuts to service, and seeks to work with Scottish Government in achieving a positive outcome for the islands.

#### **7.4.**

The Audit Scotland review of Transport Scotland's Ferry Services, published on 19 October 2017, highlights the significant investment made by Transport Scotland on the Clyde and Hebrides Ferry Services, including an increase in services, new vessels and the introduction of the Road Equivalent Tariff. Little mention is given to Orkney's Inter Island Ferry Services; however, it is addressed under section 116, 'Developments to have implications for Transport Scotland's capital and revenue expenditure'. The Audit Scotland's review of Transport Scotland's Ferry Services was presented to the Policy and Resources Committee on 28 November 2017.

#### **7.5.**

The Minister for Transport and the Islands, Humza Yousaf, visited Orkney on 23 August 2017. The visit included Inter-Island Ferry Service discussions with the Island Community Council Transport Representatives at the Ferry Services Consultative Forum. The main feedback from transport representatives was the need for replacement ferries and a slightly longer operating day, for work and leisure purposes. Future funding and responsibility of Orkney's Inter Island Ferry Services was also discussed.

#### **7.6.**

The Leader of Orkney Islands Council met with the Minister for Transport and the Islands on 26 October 2017 to discuss the matter of fair funding of Orkney's Inter-Island Ferry Services further. The Council Leader and Head of Finance along with the Leader and Chief Executive of Shetland Islands Council met with the Finance Secretary and the Minister for Transport and the Islands on 16 November 2017 to further press the case for fair funding.

#### **7.7.**

A debate took place in the Scottish Parliament on 6 December 2017 on motion S5M-09379 calling on the Scottish Government to set out to the Parliament how it intended to honour a commitment to "the principle of fair-funding in the provision of ferries and ferry infrastructure" in relation to Orkney and Shetland internal ferry services. Following the debate, the motion, as amended, was agreed by the Parliament.

#### **7.8.**

After a further period of considerable engagement, primarily between the Council Leader and the Finance Secretary, and positive support from the Rural Economy and Connectivity Committee in their 19 January 2018 report on the draft Scottish Budget in which the Committee called on the Government to treat the matter of fair funding as a priority and to satisfactorily resolve it by the conclusion of the current consideration of the draft budget, the Scottish Government announced in stage one of the debate on the budget its intent to provide supplemental grant funding of £5,500,000 to cover the deficit funding gap in relation to the revenue funding for Orkney Ferry Services for 2018 to 2019.

## **7.9.**

The Scottish Government commitment for 2018 to 2019 is excellent news, finally securing recognition of the principle of fair funding for lifeline ferry services and a contribution towards a very challenging budget settlement for Orkney. There is also political commitment to continuing the dialogue in relation to long term funding security beyond 2018 to 2019 with the Council expectation being that the recognition of the principle this year establishes a very strong foundation for onward funding arrangements. Discussions will therefore continue with the Scottish Government regarding long term fair funding for ferry services.

## **7.10.**

The Council has previously agreed on the principle of transferring the funding of Orkney's Inter Island Ferry Services from the Local Government settlement to Transport Scotland subject to no financial detriment to the Council and that the terms and conditions are agreed by the Council. The feasibility of this transfer was confirmed at officer level between the Council and Transport Scotland, but this has yet to be formally put into place.

## **7.11.**

Therefore alongside, but separate to, the fair funding discussions referred to at section 7.8 above, it is now necessary to directly consider the principle issue of transfer of responsibility of Orkney Ferry Services to the Scottish Government.

# **8. Options Appraisal**

## **8.1.**

The Council needs to consider how to address the long term future of inter-island transportation services to the islands. There are two main options for the Council to consider in this regard.

## **8.2.**

Option 1 – Maintain Scottish Government Fair Funding and Retain Responsibility.

### **8.2.1.**

The Fair Funding discussions with Transport Scotland have been on the basis that the Council is responsible for the day to day running and delivery of the Inter Island Ferry Services and revenue and capital is increased to reflect this. This means that responsibility and decision making for services is retained within the islands.

### **8.2.2.**

Priority 1 as outlined at section 6.2 above, is to address the increasing funding gap, currently met by Orkney Islands Council, but secured for 2018 to 2019 through a supplemental grant of £5,500,000 from the Scottish Government.

### 8.2.3.

The ferry services provisional budget for 2018 to 2019 is summarised as follows:

Description.	Provisional Budget for 2018 to 2019.
Turnover	£2,632,000
Operating cost	£12,780,184
Gross Loss	-£10,148,184
Grant Aided Expenditure	£4,650,100
<b>Net Deficit</b>	<b>-£5,498,084</b>

### 8.2.4.

It should be noted that the figures outlined above are based on the current fare structure. Any call for reduced fares on the Orkney Ferries service, in line with introduction of Road Equivalent Tariff on the Northern Isles, would result in an increased deficit figure.

### 8.2.5.

Addressing the existing funding gap to operate inter island ferry services is only a short term option as this does not address the current issues associated with fares, frequency of service and length of operating day. If services were increased to reflect services operated across the rest of Scotland, then this would result in the need for more crew, fuel and increased maintenance costs. The revenue ask would therefore be significantly more than an additional £5,498,084 and is estimated to rise by a further £1,500,000 to £6,500,000 extra to deliver the STAG options. Priority 1 does not consider the immediate need for vessel replacement and expected capital costs over the next 20 years.

### 8.2.6.

Priority 2 of the fair funding discussions is to achieve a long term funding solution for inter-island air and ferry services for both revenue and capital, including vessel replacement. This takes into consideration the issues outlined at section 8.2.5 above.

### 8.2.7.

The Council could continue to engage with Scottish Government on the basis of retaining responsibility locally however capital and revenue funding must be increased to reflect the cost of operating the service. This option is likely to become more cumbersome and higher risk for the Council in the long term as it would continually require to react to Scottish Government service and funding level changes elsewhere in the country on a retrospective basis and carry the risk of a delayed funding settlement from the Scottish Government. This option would increase the risk of delay to the Council in full fair funding, and also reduce the flexibility which could be achieved to operate services on a national level.



### **8.3.**

Option 2 – Pass Responsibility of Ferry Services to Transport Scotland.

#### **8.3.1.**

The second option, as outlined in the Scottish Ferries Plan, is to transfer responsibility of internal ferry services to Transport Scotland. The principles of transferring responsibility would need to be agreed by both parties before proceeding further.

#### **8.3.2.**

If services were to be transferred to Transport Scotland then it is likely that they would be tendered in a similar way to the Northern Isles Ferry Services contract. In fact, in order to create efficiencies and integrated booking, consideration could be given to tendering internal ferries with the Northern Isles Ferry Services contract for example.

#### **8.3.3.**

Whilst responsibility of internal ferry services would be lost locally, it is fully expected that Transport Scotland would need to enhance services to reflect that operated across the rest of Scotland and therefore the issues associated with fares, frequency, length of operating day and replacement vessels, would sit with Transport Scotland. It also expected that Transport Scotland would seek to maintain a strong relationship with the Council in delivering services in order to ensure local responsiveness and flexibility in terms of ensuring the most efficient public sector solutions for the services

#### **8.3.4.**

It is currently unknown what revenue and capital implications this would have to the Council as this is yet to be discussed in any detail with Scottish Government. Should the Council ask to transfer responsibility of the service then the Scottish Government would need to draft the principles of transferring responsibility of Orkney's Inter Island Ferry Services to the Council to consider before implementation. The starting point for the Council would be that the transfer should be at no net detriment to the Council in revenue or capital terms.

### **8.4.**

The decision of the Scottish Government to deficit fund services for 2018 to 2019 and to maintain a dialogue in relation to securing long term fair funding for lifeline services is very positive. This decision effectively secures the principle of Scottish Government fully funding these services. However, as demonstrated in the period October 2017 to January 2018, this is not a fully secure position for the Council and there arguably remains a level of uncertainty and high risk to the Council that Option 1 will not be delivered by the Scottish Government.

## **8.5.**

Option 2 is therefore considered to represent the most financially prudent option for the Committee based on present circumstances. If the Committee is minded to adopt this option as the preferred option, then it is recommended that the principle of transfer of ferry services to the Scottish Government is approved and that powers are delegated to the Chief Executive, in consultation with the Leader, the Head of Finance and the Solicitor to the Council, to agree terms for the transfer of responsibility for Orkney ferry services to the Scottish Government as soon as possible. As stated above, this new dialogue would take place in parallel to, but separate to, ongoing discussions in relation to fair funding for ferry services under the present model of delivery.

## **9. Financial Implications**

### **9.1.**

During 2016 to 2017, the cost to operate Inter Island Ferry Services reached £10,437,000 less £2,811,000 achieved through fares income. Government support received through Grant Aided Expenditure was £4,745,000, leaving a shortfall for the Council of £2,881,000. The shortfall in the budget position for 2017 to 2018 is anticipated to be further increased and was also starting from a position that included the use of £600,000 of Orkney Ferries reserves as the Council budget was particularly stretched. The budget shortfall for 2018 to 2019 had been estimated at £5,500,000 as set out at section 8.2.3 above.

### **9.2.**

The shortfall of £2,881,000 in 2016 to 2017 met by the Council was an overspend in budget terms of £381,000, due to increased refit costs. It is anticipated that costs will continue to rise in subsequent years due to an ageing fleet. The Council is unable to sustain the Inter Island Ferry Services without continued support from Scottish Government towards revenue and capital funding.

### **9.3.**

The detriment to the Council over the past 28 years since the ferry funding became part of the Council's Grant Aided Expenditure has been approximately £44,000,000 in terms of spend. The Council having responsibility of Orkney's Inter Island Ferry Services has therefore resulted in a substantial draw from Council reserves.

### **9.4.**

There is a contrast in the level of budget growth that has been achieved in services directly funded through Transport Scotland when compared to the Services which are currently funded through block grant, as shown in the undernoted table.

<b>Funding Source.</b>	<b>2006 to 2007.</b>	<b>2015 to 2016.</b>	<b>Increase.</b>
Scottish Government Services and Piers/Harbours.	£62,000,000.	£166,000,000.	168%
Local Authority Services Grant Aided Expenditure (LASG).	£12,217,000.	£13,027,000.	7%
Orkney's share of LASG.	£4,299,000.	£4,517,000.	5%

## **9.5.**

The revenue costs currently met by the Council are on the basis of a service that does not currently meet the standards as outlined in Transport Scotland's Routes and Services Methodology. Should services increase to a comparable standard with that operated across the rest of Scotland, then the revenue cost to operate internal ferry services in Orkney would increase further.

## **9.6.**

As well as the immediate fairer funding for ferries issue a significant challenge facing the Council in relation to Orkney's internal and external ferry services is the capital investment required to modernise the ferry fleet.

## **9.7.**

As detailed in section 7 above, the Scottish Government has announced its intent to provide a supplemental grant to the Council for 2018 to 2019 to cover the £5,498,084 deficit for this year. There is a political commitment to continuation of dialogue in relation to long term funding beyond 2018 to 2019.

## **10. Legal Aspects**

### **10.1.**

Section 153 (2) of the Local Government (Scotland) Act 1973 empowers the Council to "acquire, provide, maintain, improve and operate any ferry situated wholly or partly within their area".

### **10.2.**

Orkney Ferries Limited operates the ferry services on behalf of Orkney Islands Council under Service Level Agreements dated 30 May 2008.

### **10.3.**

The Service Level Agreements state that Orkney Ferries Limited will operate the "Approved Services" and in return for funding from the Council. The definition of "Approved Services" covers inter-isles ferry services as approved by the Council.

## **11. Contact Officers**

Alistair Buchan, Chief Executive, extension 2101, Email [chief.executive@orkney.gov.uk](mailto:chief.executive@orkney.gov.uk)

Gavin Barr, Executive Director of Development and Infrastructure, extension 2301,  
Email [gavin.barr@orkney.gov.uk](mailto:gavin.barr@orkney.gov.uk)

Brian Archibald, Head of Marine Services, Engineering and Transportation,  
extension 2703, Email [brian.archibald@orkney.gov.uk](mailto:brian.archibald@orkney.gov.uk)

Laura Cromarty, Transport Manager, extension 2535, Email  
[laura.cromarty@orkney.gov.uk](mailto:laura.cromarty@orkney.gov.uk)

## **12. Appendices**

Appendix 1: Previous Decisions of the Council.

Appendix 2: Background of transfer of responsibility to Orkney Islands Council and  
Local Authority Funding.

Appendix 3: Joint Statement of Fair Funding Requirements – Orkney Islands Council  
and Shetland Islands Council, June 2017.