

South Carolina Pupil Transportation Privatization Study

Prepared by TransPar Group

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Introduction

TransPar Group, Inc. was engaged to analyze the South Carolina pupil transportation program administered by the State Department of Education (SDE) and report on the possibilities for privatizing all, or aspects of, the current system.

TransPar's Qualifications

TransPar Group is a pupil transportation consultant. Formed in 1995 by executives from a major school bus transportation contracting company, TransPar provides school districts and governmental entities with consulting and management services. TransPar has served over 100 clients nationally with a typical engagement entailing an audit of a school district's or county's bus routing, maintenance, driver recruiting, safety, budget/finance, and related programs. The findings are confirmed with the client, and action plans developed to address any areas of need. Such services have been performed for Denver, CO, Wake County, NC and Clark County (Las Vegas), NV. Additionally, TransPar provides on-site transportation system management teams, such as a transportation director, routers, customer service reps, and dispatchers. Such services are currently being provided for nine districts including Chicago IL, Kansas City MO, St. Louis, MO and Oklahoma City, OK.

TransPar assigned its most senior operations and finance professionals to this study. These individuals each have 20+ years of pupil transportation industry experience, all having served upon the senior management team of a large national school bus contractor. Mr. Parris has 35 years of industry experience ranging from managing school bus terminals to regional management responsibilities. Mr. Martin has been in the industry for 25 years, starting in school bus sales, then President of Mayflower Contract Services – operating 10,000 buses nationally, then as President of NSTA (National School Transportation Association). Mr. McHenry is a CPA and was the CFO of Mayflower until the sale to Laidlaw. After Mayflower was merged into Laidlaw, Mr. Martin co-founded TransPar in order to help Districts and other governmental entities provide responsible student transportation.

Study Purpose & Process

The purpose of this particular study is to determine the privatization potential for pupil transportation in South Carolina. In order to achieve this, TransPar confirmed the operational processes and resources of the South Carolina pupil transportation program. Information gathering meetings were held with the Columbia management team. Thereafter, six SDE bus shops were selected by TransPar for on-site visits and in-depth analysis of responsibilities, procedures and policies. At least one shop in each of the five regions was selected in order to achieve a statewide analysis and allow identification of each area's perspectives and challenges. Local managers and staff were interviewed, using a pre-prepared list of open ended questions. TransPar's visits included unrestricted meetings with SDE regional managers and specialists, and school district officials when possible. The contracted services in Beaufort and Charleston were assessed. In this manner, TransPar determined the key controls, factors, strengths and weaknesses of the current program.

The SDE office provided an extensive array of operational and financial data by region, shop and district. Each shop tracks and reports specific maintenance, staff, safety, service, fleet, finance and other data, providing the SDE an excellent means of managing both state-wide and local matters. TransPar was supplied copies of previous privatization study reports addressing the South Carolina program. These were reviewed and discussed.

This process identified several key facts, factors, strengths, and challenges for the State Department of Education (SDE) as it considers privatization opportunities.

Finances, Funding & Fleet

The state pupil transportation program is administered and managed by the SDE; this includes the ownership of the state's school bus and service vehicle fleet, and the fuel, repair, and insurance of these vehicles. Approximately \$76 million was expended in fiscal 2006 to maintain and service these services. In addition, the SDE allocated \$135 million for bus drivers and related costs, of which the SDE provided \$48 million and the local districts provided the \$87 million balance of the funding.

State funding for the SDE has not been sufficient to allow the SDE to maintain a reasonable standard of fleet and facility resources, nor expand the fleet size. The 5700 buses operated in fiscal 2006 averaged 13.9 years of age and 194,000 miles. The industry standards for school buses are that replacement age should be 12 years and odometer miles should not exceed

180,000, thus the industry average age would be 6 years and average miles would be 90,000. The SDE's fleet is well outside of industry standards which places pressure on service reliability, repairs, and operating costs. Over 1300 engines, transmissions and rear-ends were replaced in fiscal 2006 creating repair costs, bus downtime, and service interruptions that would be avoided with a modern fleet. Additionally, new buses are more fuel efficient and include improved safety features. Fiscal 2007 initially funded the purchase of 642 new buses to replace older units. Supplemental funding in late fall from unclaimed lottery winnings allowed the purchase of another 70 buses, thus 712 new units will be transitioned into the fleet this year.

Most SDE shops were built in the 1960s. Funding has not allowed for the degree of upkeep, remodeling and expansion needed to meet the state's growth in pupil transportation and properly support the aging fleet.

Funding pressure is also impacting the bus repair operation as technicians wages are below market. Turnover is high and vacant mechanic positions are common. Attracting and retaining skilled technicians without a competitive pay structure is an ongoing management and operational challenge.

SDE Organization & Accountabilities

The SDE Office of Transportation is organized as follows:

<u>Level</u>	<u>Primary Accountabilities</u>
Central Office – Management	state program execution & monitoring fleet & resource allocation funding compliance
Area Supervisors	state program service delivery supervise County Supervisors training, costs, complaints, compliance
County Supervisors	supervise shops coordinate service with districts compliance, complaints, maintenance
Shop Foremen / Technicians	fleet maintenance, fueling, inspections

TransPar determined that this structure and span of control is reasonable. The State's program is being soundly executed within this structure. Directives and policies were clearly communicated. Managers and supervisors possessed sufficient talent and experience to meet system requirements and assure a high degree of stability.

Cost Efficient System

The State's current organizational structure, policies, laws, and focus combine to create a gate-keeping process that results in very tight controls over the pupil transportation program and costs. South Carolina's state administered program prohibits adding non-essential buses, employees, or ancillary programs. Carefully managing the growth in resources and service keeps operating costs down. One central point of control – the SDE – causes the system to be standardized and cost efficient. Multiple points of control – such as school districts – will cause the system to bifurcate, with varying standards, services and economies. Lower costs result in lower taxes. Any increase in costs would likely relate to an increase in state or local taxes. South Carolina is the only state that manages school bus growth and costs in this way.

South Carolina is the only state with such a centralized structure. In most states the school district determines vehicle purchase policy, service, and cost, then it may be subsidized in various means by the state. A shortcoming of the South Carolina structure is that it prohibits local service flexibility when using the state funded school bus fleet. Pupil transportation has historically been driven by geographics, i.e. getting the student to the nearest neighborhood school. Modern educational programs have created magnet, choice and vocational schools. Special education service continues to expand. When state laws and regulations do not allow districts the freedom to use the state fleet in unrestricted ways, discord arises between the trio of state, district and parents. The demand for more services exceeds the availability of services, services that are defined by law and limited by funding.

A few districts have taken steps to close the gap between supply of state resources and local service demand. Some have purchased buses with local money to supplement educational programs or bus services. Charleston has supplemented service by purchasing large numbers of district owned buses and hiring a private bus contractor with additional buses. Thus, a handful of districts are already supplementing the state program. The option of district fleet ownership and/or contracting is available, but is perceived to be viable only where the local economics allow.

The current state-controlled program offers other advantages. Liability levels are capped by state law and insurance costs are very low. Economies of scale are achieved in purchasing insurance, parts, fuel, and other services. The current structure facilitates a prompt and organized State response to industry matters (such as safety issues or vehicle recalls) and regional events, such as emergency evacuations.

Privatization Plus and Minuses

The privatization of pupil transportation may address a variety of state and local concerns, such as divesting certain governmental accountabilities, downsizing government, moving control closer to the taxpayers, and allowing for more local flexibility as to bus services, policies, etc. A fundamental assumption is that privatization will result in more efficient and cost effective services. However, TransPar cautions that the South Carolina's system is so unique that privatizing it presents a variety of issues that must be carefully considered before proceeding.

First and foremost, the current system is very simple, lean and cost efficient. Policies are clear and rigidly enforced. A contractor will be at an immediate disadvantage when pressured to meet ever-expanding local service needs with available state resources. They will need to meet market rates for drivers and mechanics. They will pay more for insurance, and must charge enough to make a profit. TransPar does not expect that a private contractor will be able to perform the service any smarter or more efficiently than the SDE and school districts. Therefore, cost reduction is not a guaranteed byproduct of pupil transportation privatization.

Second, the funding challenge makes it very difficult to compare the current program costs to a contracted system's costs. The fleet's age is older than a private contractor would own. A newer fleet would substantially increase capital investment by the state. If the contractor is required to provide the vehicles to upgrade the fleet, the state will be required to provide comparable funding to pay for the increased operating costs of the contractors.

Third, current laws favor state control and ownership. These laws were not created with privatization in mind, as the state has always centrally managed pupil transportation. Private operators will not benefit from the state's liability limits, and they will not be exempt from various operating taxes.

Last, it is not feasible to privatize the entire state's pupil transportation system all at once. No one single provider has the resources to undertake such a significant business obligation. The state would also not want to have a single

provider own its entire fleet, to do so would leave no opportunity for competition in future bidding; no other contractor would have the fleet resources to take over the statewide fleet needs, even with a year's advanced notice. The complexity of unbundling the current SDE system, while still retaining a reasonable degree of state oversight and control is daunting. At a minimum, the state or school districts should retain some authority over bus routing and any bus additions.

Privatization Options

Options range from outsourcing some or all aspects of the program and/or outsourcing state-wide or on a district by district basis. Four primary possibilities were explored.

Central Office – The functions of managing, directing and administering the state program could be outsourced. A management company could direct the program and report to the Superintendent's office. The privatization could conceivably flow down the organizational chart to the Area or County Supervisor level. TransPar concludes that the functions of the state office are being performed efficiently and effectively and that there is no determinable upside to pursuing this possibility. This is not done in any other state.

Bus Service / Contractors – A bus contractor could be hired to operate the state's buses. This is not done in any other state. Limited outsourcing is now performed for Beaufort and Charleston; the school districts contract their services, although the contractor in Charleston provides supplemental buses. Any District has the option of hiring a contractor, provided it has the financial resources to do so. The State's experience in Beaufort and Charleston has been that while service has been enhanced and expanded, there is an incremental cost increase for such.

Bus Ownership / Leasing / Contractors – A bus contractor could be hired to provide a turn-key bus operation including drivers, buses, maintenance, insurance, routing, etc. This is the most common form of pupil transportation outsourcing in the United States, wherein the contractor is totally accountable for all school bus operations. However, this type of program is not done at the state level by any other state. Another possibility is to lease newer buses as a means of supplementing the new bus purchase funding by the State. South Carolina laws as to taxes, bus ownership regulations, insurance, and school activity trips will restrict or inhibit private company service delivery. Turn-key outsourcing on a state-wide basis with one vendor is impractical, thus the state-wide economies of scale with the current program will deteriorate. Overall, if this is determined to be the privatization option of choice, legislation should be undertaken to

alleviate the barriers private companies face in this regard. Otherwise, the costs and complexities of pursuing this option will be substantial.

Fleet Maintenance & Repair Services – A core responsibility of the SDE is that of providing shops and fleet repair services. The service could be outsourced on a service area by service area basis. Pursuit of this option addresses: i) the issue of SDE technician pay being below market, ii) the need to open additional service centers because of bus service needs in developing areas, and iii) creates a pilot program – a starting point - for further privatization. There are viable private companies that perform this type of service, and would bid on such for the SDE. These service needs are quantifiable and straightforward, which will allow for competitive bidding. While there is not an initial expectation that outsourcing will reduce costs – particularly with the age of the fleet – other efficiencies may arise that could benefit the SDE program, cost or service level. Starting here would allow quantification of such.

Contract & Cost Responsibility

The current South Carolina pupil transportation program is centrally managed. Finance and operational decisions are made with state-level laws, resources, funding (and funding constraints), demographics, and initiatives in the forefront. This state-wide “gatekeeping” promotes standardized operations, economies of scale, a strong degree of discipline and constraint when appropriate, and – ultimately – a low operating cost. Thus, taxpayers benefit and are not subsidizing pupil transportation services that exceed the state standards.

If accountabilities for student transportation shift to county consortiums, counties, and/or school districts, the decentralized decision-making will create more decision makers and decision points. Local public pressure will influence transportation decisions and result in service expansion creep and less cost control leverage. Additionally, it is unlikely that local decision makers will have the degree of pupil transportation knowledge and experience presently provided by the central management team, leading to solutions that may vary from past practices. The likely outcome is that transportation services will expand and costs increase, placing the subsidization of such onto local taxpayers.

If the state is not going to fully fund school transportation, South Carolina should consider designing and implementing a pupil transportation funding formula that controls costs while creating a fair degree of balance between state and local funding. Most states use a formula that compensates school districts based upon a relationship of pupils transported, miles traveled, and sometimes allowable costs. The districts that are more “efficient” receive a higher level of

funding than those districts that are less efficient. The funding formulas reward districts that abide by the state regulations and norms; those that waver will finance a bigger portion of their transportation program. These formulas remove the emotion, and place the district in the driver's seat as to controlling their ultimate net transportation costs.

Critical to Continuing Progress

This study identified misperceptions about privatization as compared to decentralization. *Privatization* is the divesting of government functions. *Decentralization* is the delegation of centralized responsibilities. The concept of local control versus state control follows the definition of decentralization and can occur without privatization.

Proponents of privatization typically contend that the private sector can perform the service better and/or at a lower price than the government. They promote that the private sector has the expertise, know-how, and resources to best address the service without the constraints of governmental bureaucracy. Privatization is easier to pursue where laws and regulations allow a level playing field between government and the private sector.

Proponents of decentralization contend that the decision making should be delegated or pushed down to those closer to where the services are delivered. They offer that those truly impacted by the process are in a better position and better equipped to deal with it. Decentralization is easier where the service performed is standardized and the learning curve is slight or moderate; this is not the case in South Carolina. Decentralization is difficult when constraints exist that limit the new decision maker's flexibility to respond, such as with South Carolina's funding constraints and pupil transportation laws.

Decentralization can threaten the efficiencies the state enjoys with the current SDE program. Companion state guidelines would be needed to define the parameters within which the Districts should operate, and the repercussions of wavering from those parameters.

TransPar's opinion is that South Carolina's pupil transportation program bodes better for decentralization than privatization. Privatization is currently inhibited by the level of state funding, the age of the fleet, insurance laws, and other regulatory constraints that will not allow the private sector to deliver better service at a lower price. On the other hand, decentralization in conjunction with a funding formula that guarantees the state will maintain the state's share of

funding in the future will allow local decision makers to address their wants and needs, and allow districts to fund any related cost increase.

Other issues significantly inhibit the pursuit of both privatization and decentralization. The lack of a defined school bus replacement and funding plan creates many unknowns and challenges, ranging from how to address growth, how to best maintain the older fleet, and how to continue providing dependable service. The concept of funding a 12 year bus replacement program has been discussed, but not embraced. Pupil transportation options will be restricted until a program that defines the vehicle replacement cycle is implemented.

Throughout America, public sentiment has caused schools to reduce the walk distance for younger children, typically third graders and younger. Parents are not comfortable with 6-9 year old children safely navigating today's multi-lane streets and congestion, and worry about the child's general welfare. South Carolina state law does not allow for state provided school bus transportation within 1.5 miles of the school; this service can be provided with state resources but at district expense. Regulations and funding should be modified to address state support of the 1.5 mile and other hazardous walk situations.

As referenced previously, the SDE technician's (mechanics and utility personnel) pay scales are below market, particularly in the areas with a robust economy. This problem should be addressed without regard to confirming a privatization direction. Pursuit of privatization or decentralization only passes along the burden for addressing such.

Study Conclusions

Sweeping privatization of the SDE pupil transportation program is not viable. There is no one single contractor that could – or should – undertake such a venture. The state has remote and diverse service areas. There is no foundation for proving that costs can be reduced. The fleet age and lack of a defined replacement program restricts competitive alternatives. Statewide privatization is not done in any state.

Targeted privatization is an alternative that will allow service to be customized for local requirements, but again there is no evidence that operating costs can be lowered and instead a real possibility that costs may increase. Regardless, some state oversight will still be necessitated because of State laws and regulations.

TransPar noted a lack of consensus as to the objectives of the various political and community factions. The differences of opinions as to privatization

versus decentralization should be clarified, and a direction quantified so that concerns are addressed head on and ultimately satisfied. Otherwise, the key issues as to South Carolina's pupil transportation program may not be resolved. For example, if an underlying goal is to increase local control with the likelihood of creating modest increase in costs, then decentralization is the better direction. If the goal is to divest state and local government of operating a bus system, then privatization is the direction to go.

Next Steps

The Legislature and state officials should confirm the objectives for any further discussion or initiatives. What are the top three goals for making any alterations to the current system? Given this, the appropriate path to achieve those objectives could be more easily identified.

The SDE should pilot a privatization and/or decentralization effort to validate the pros and cons, and better define the state-wide goals. Pursuing the privatization of a maintenance service area by issuing a RFP would provide the SDE with answers to many unknowns and a roadmap as to how to proceed.

Another reasonable possibility for a pilot may exist, but needs further assessment before pursuing it. The SDE effectively already has a decentralized pupil transportation pilot underway in Beaufort. Beaufort utilizes First Student to operate the State's buses. This presents an ideal case study from which the cost and service delivery aspects could be quantified and compared to State cost and service delivery standards. TransPar cautions that overall conclusions not be prematurely drawn based upon Beaufort's current system as a careful analysis will pinpoint certain positives and negatives within the Beaufort system, allowing the State to accentuate the pros and improve upon the cons, thus piecing together a viable model for South Carolina.

Regardless of all other initiatives, the SDE should promote enacting legislation and revising state laws to address the matters that inhibit service delivery, privatization and decentralization. Doing so will allow for more options, more competition, and start moving South Carolina toward a program that more closely resembles those in effect throughout most of the country.

TRANSPAR GROUP

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