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Palestinian Authority

MINISTRY OF TRANSPORT

TECHNICAL ASSISTANCE IN THE
PASSENGER TRANSPORT SECTOR DEVELOPMENT

FINAL REPORT

April 2009

Sustainable Development Department

Middle East and North Africa Region

CURRENCY AND EQUIVALENT UNITS

(As of April 2007)
Currency Unit = Israeli New Shekel (NIS)
US$ 1.0 = NIS 4.10
NIS 1.0 = US$ 0.24

ABBREVIATIONS

CC	Consolidated Company
CEO	Chief Executive Officer
GOI	Government of Israel
Km	Kilometre
LU	Local Units
MIGA	Multilateral Investment Guarantee Agency
MOF	Ministry of Finance
MOP	Ministry of Planning
MOT	Ministry of Transport
MPWH	Ministry of Public Works and Housing
NIS	New Israeli Shekel
OCHA	Office of the Coordinator of the Humanitarian Affairs
PCN	Project Concept Note
PNA	Palestinian National Authority
PCBS	Palestinian Central Bureau of Statistics
PLC	Palestinian Legislative Council
TA	Technical Assistance
TOR	Terms of Reference
WB	World Bank
WBG	West Bank and Gaza
VAT	Value Added Tax

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TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

1. Executive Summary

The 2007 Transport Sector Strategy Note identified that transportation in the West Bank and Gaza faces extreme challenges, to the extent that mobility for people and goods is severely curtailed, with consequent impacts on the broader functioning of society and the economy. The constraints on personal mobility within the West Bank and Gaza has greatly reduced the market for travel, and hence the business and viability of the transportation sector. Operators are in a loss-making situation and cannot afford fleet renewal, so the quality deteriorates while some buses eventually stop running and some operators go out of business.

One strand of the World Bank response to these challenges has been to provide assistance to the Ministry of Transport of the Palestine National Authority (PNA) to develop a practical strategy for action in co-operation with the operator sector. This activity has been supported by the World Bank and the Trust Fund of the Government of Norway. The approach has been to:

- Carry out a review and data gathering of the bus operating sector and the framework in which it operates
- Design a concept and strategy for the development and rehabilitation of the sector
- Develop more detailed working mechanisms for the various strands of the strategy
- Work with the main stakeholders to develop practical implementation mechanisms

This report presents the main findings and recommendations, and provides a recommended time-bound action plan. The report provides a basis for the policy-makers at the Ministry of Transport to determine the future direction of the sector, and for investors and other stakeholders to consider the possibilities for investment and engagement with the sector.

The review of the sector is presented in Chapter 4 of this report, and in more detail in the supporting report prepared by An-Najah University. It shows that the operator sector consists of small companies with an old fleet, relatively low productivity, and a very limited capacity to replace its assets. The sector is unsustainable as it currently stands, and unless there is intervention, more of the operators will go out of business and the formal bus/minibus supply in the West Bank and Gaza will diminish. The sector will only be able to survive and develop if it can achieve organisational and operational efficiencies, improve productivity, and generate surpluses for investment, as described in Chapter 5.

1.1. *Strategy for Sector Development*

Based on the review of the sector and the policy guidance from the Ministry of Transport, the Bank team has developed a suggested strategy for the sector. The core principle is to achieve consolidation among the small operators into companies of sufficient size to achieve network, organisational and operational efficiencies, and to restructure their businesses to be able to generate surpluses after expenses. This would provide the capacity for asset renewal. To encourage the consolidation of operators and network, and to protect the revenue streams, exclusive franchises for geographic areas would be granted to the consolidated companies.

The Strategy consists of four main strands:

1) *Offer Area Concessions for the fixed-route passenger transport services to competent transport operating companies*. The Area Concessions would be for specific geographic areas in West Bank and Gaza for a specific period of time with possibility of renewal subject to satisfactory performance. The Concessionaire would define the specific services within parameters set down by the Ministry of Transport.
2) *Facilitate the existing operators to form legal entities* that can bid for and operate the area concessions to a high standard over the concession life. The encouraged option is to merge existing companies into a new business, but other forms of affiliation could be acceptable as long as they have legal form and proper accountability.
3) *Assist operating companies to acquire vehicles and depot/maintenance facilities* either by establishing a bus leasing company or by making suitable financing channels available. A bus leasing company would acquire a suitable fleet of large and mid-sized buses and make them available on long-term lease to the holders of the Area Concessions.
4) *Facilitate the establishment of a support services company* which would provide terminals, customer-facing services, ticketing, passenger information in a common way throughout West Bank and Gaza. It would also provide higher-order business services for the operating companies, such as network planning, technical research and know-how transfer.

Following the workshop and feedback from the stakeholders, the Bank has carried out further studies to collect and analyse data about the services and operators, and prepared more detailed working notes in the main strands of the Concept. The key points of these discussion notes are presented in this report.

1.2. Area Franchises

The Area Franchise concept is presented in Chapter 7, with a worked example for the Nablus and Tulkarem area. The Discussion Note contains a discussion of the options for each aspect of the Franchise. In the proposed Franchise mode, the Ministry of Transport would:

- establish the boundaries of the Franchise Areas
- establish the pre-qualification criteria for a suitable operator
- enter contracts with suitable operators for the Area Franchises
- define the services to be included in the Franchise
- set the coverage and service level parameters for the passenger transport services, within which the Franchisee would do the detailed design
- set the quality parameters against which the Franchisee would be measured and appraised

The Area Franchises would be expected to be self-financing, but would receive reimbursement from Government for any free or reduced-tariff customers they are required to carry. The Franchises would be for a fixed period, suggested to be 5 years with an automatic extension of a further 5 years if performance meets the agreed criteria.

1.3. Operator Consolidation

Chapter 8 deals with operator consolidation. The existing operators will need to form into entities that can enter into contracts and take on service and financing obligations. Two concepts are currently under consideration:

1) Formation of three Unions of bus operators (North, Central, South), as proposed by the Ministry of Transport. Each Unions would have a legal basis, a Board of Directors, and a professional management. It would operate in a co-operative way, but the identity of the companies would remain distinct and their assets would not be integrated.
2) Consolidation of the bus operators into new companies in which the assets of the companies would be combined, and the original identities would be absorbed. The new company would plan and organise all of the services to meet passenger demand and with optimal allocation of resources.

Consolidated Companies are necessary for Area Contracts and for long-term lending and investment, but there are concerns among the operators about this approach, including:

- the current willingness of operators to participate and to give up their identities and historic operating permits
- the difficulty to evaluate the assets
- the difficulty and time taken to dissolve the existing companies and form the new ones

A transition approach is needed, beginning with Unions – to which the Operators have now committed – and within a period of about 2 years to evolve to Consolidated Companies. Two recommendations are made for the Unions:

1) Develop a strategy, business plan and implementation plan that sets out clearly the targets and achievements that are expected from the Union, the actions will be implemented to achieve them, and the financing plan. The Charter of the Union, the organisational structure, and the agreement among the participating operators should be based on the business activities.
2) Within the first months of the Union's existence, develop the Migration plan from the Union to a Consolidated Company.

For the Consolidated Companies, it is recommended that these should be formed as new entities rather than a merge of the existing companies. This would enable the companies to begin with a "clean slate" and would avoid the complexities and potential delays associated with liquidating the existing companies (some of which may wish to remain in business for non-scheduled services).

1.4. Fleet Renewal

There is an urgent need to replace a large proportion of the fleet within the next 2-3 years, otherwise it will cease to operate and the business will be lost to shared-taxis and personal transport. The priority is to replace the large bus fleet, since these provide the greater part of the capacity. However, new vehicles are expensive to procure and they cannot share parts or maintenance with other vehicles (unlike minibuses which have the same chassis, engine and gearbox as commercial vans which are available in the West Bank).

A strategic decision needs to be taken (or it will occur by default) on whether to:

a) Systematically replace the life-expired fleet with new buses over a 3-5 year period, so that the fleet has been rehabilitated and the quality substantially improved; or
b) In order to save funds, replace life-expired vehicles with the 12-year old Israeli buses and work them to the end of their technical life.

The Bank recommends strategy (a), replacement with new buses, even if this has to be done over an extended timescale due to limitation of available funds. Depending on the vehicle type selected, the cost of a standard urban 12 metre bus can range from $70,000 to over $300,000. Keeping in mind the requirements to conform with Israeli specifications, the need for durable buses, and the limits on the price that operators can afford to pay, the purchased vehicles are likely to be in the cost range of $100,000 to $150,000. This means that the investment requirements for large bus replacement are in the range $40-60 million over the period 2009-2012. Maintenance facilities and supplies of spare parts are additional. It will also be necessary to invest about $20 million to renew the small bus fleet over the same period.

Four options have been identified to finance new vehicles:

- Operators buy buses using their own resources or through commercial loans
- A special financing channel is made available for operators to buy buses
- Inward investment is made into the bus operating companies in return for shareholding, this provides the finance to buy buses
- Operators lease buses

Each of these options is discussed in turn in Chapter 9. For all options, lenders or investors will only be interested in companies that can show a credible business proposition, an ability to repay, sound financial forecasts, and the organisational capacity to perform and manage their business effectively. The bus operating companies will need to prepare good quality business and financial plans. They will also need to strengthen their organisational and financial structures to give confidence to potential lenders or investors. For all options, it is to the advantage of the operators to standardise the bus manufacturer and models to a small number of types, and to purchase collectively.

The option of a Bus Leasing Company is presented in Chapter 9.2 and in the associated Discussion Note. In this option, a special purpose company would be established to purchase the vehicles and make them available under long-term lease to the companies which have gained the Area Franchises. Planned and major maintenance would be carried out by the Leasing Company, and the cost included in the monthly leasing charge. The bus supplier would be one of the stakeholders in the company, as a means of ensuring good quality vehicles and lifetime support.

The main part of the financing would come from investors. The Bank has initiated contacts with a number of potential investors and donor agencies to identify the level of interest. The Bank has also explored possibilities for covering the political risk and insuring against circumstances beyond the control of the operators who would lease the vehicles.

1.5. Adapting the Regulatory Framework

The Regulatory Framework needs to be changed to support the new passenger transport business framework (the Area Franchises) and to enable the sector to develop and change. The main changes that will be required in the regulatory framework are presented in Chapter 10:

- Designate the Passenger Transport Authority, define its governance structures, and define its functions and scope of authority
- Establish that the Passenger Transport Authority has all rights on road passenger transport services, and that any such services are only operated under permit from the authority

- Enable the designated Passenger Transport Authority to enter into contracts for Area Franchises and other service agreements, to set vehicle, service and performance standards, and to organise and distribute funds to Area Franchises and any other contracted routes
- Make provision in law for Area Franchises, allowing for award of area concession and provision of exclusive service concessions for a designated area
- Make provision for services to Gaza, Israel and neighbouring countries, in the event that the restrictions on such services are removed
- Define relationships with other key stakeholders such as Municipalities and Governorates
- Strengthen enforcement powers, where required

This will require a comprehensive review of the relevant legislation and regulations, examining the extent to which they currently permit, limit, prohibit, or simply do not make provision for the new passenger transport framework.

A new capacity is required at the Passenger Transport Authority to support the new regulatory framework. The Public Transport Department needs to adapt to:

- provide effective regulatory capacity
- acquire technical capacity and knowledge to manage and support the sector

Based on international good practice and the emerging requirements in Palestine, the sector-specific Functions of the Passenger Transport Department are presented in Chapter 11, and would be:

- Set the Policy for the passenger transport supply
- Develop, monitor and manage the Area Franchises and their associated Contracts
- Establish and manage the administrative and legal processes for permit issuing
- Define and monitor performance and quality standards of the services and operators
- Assess the effectiveness of supply through research, and intervene where required to establish new routes or strengthen existing ones
- Set tariffs and financial policy, based on good knowledge of the industry business and cost structure
- Arrange reimbursement of free and reduced-rate travel
- Harmonise (and develop where necessary) integrated customer-facing services
- Enforce regulations, control against unauthorised operations
- Work with Municipalities to improve operating conditions for passenger transport services and to improve terminals, passenger facilities, parking, and upgrade bus stops
- Carry out research on the passenger transport sector
- Acquire and transfer international know-how and provide technical guidance to the sector

1.6. Timeline

A time-bound action plan is presented in Chapter 13. This is based on a two year period in which the legal Unions are established, and the needed preparatory actions are implemented for the Area Franchises, which could be launch at end-2010.

2. Introduction

The mobility of people is fundamental to their ability to participate in society. In turn, society can only function well when the full range of its members can contribute to the economy by working and trading, participate in education and personal development, and contribute to the social fabric through their community, social and leisure activities.

Transportation in the West Bank and Gaza faces extreme challenges, to the extent that mobility for people and goods is severely curtailed, with consequent impacts on the broader functioning of society and the economy. The constraints on personal mobility within the West Bank and Gaza has greatly reduced the market for travel, and hence the business and viability of the transportation sector. The security measures and road closures mean that operators provide transport services in sub-optimal conditions (long diversions, lengthy delays at checkpoints, unreliability) and incur much higher costs while achieving low productivity. Operators are in a loss-making situation and cannot afford fleet renewal, so the quality deteriorates while some buses eventually stop running and some operators go out of business.

The formal passenger transport sector in West Bank and Gaza faces collapse, and requires urgent remedial action. This report presents the results of the ongoing activity to assist the Ministry of Transport of the Palestine National Authority (PNA), supported by the World Bank and the Trust Fund of the Government of Norway, to develop a practical strategy for action in co-operation with the operator sector.

Although the current poor status of the West Bank and Gaza public transport sector partially stems from the closure regime and poor road conditions, these two issues are not addressed in the report. These two issues have already been addressed in other World Bank reports and publications. The purpose of the analysis here is to examine what can be done within the public transport sector itself, the context being exogenous.

3. Transport Challenges

The 2007 Transport Sector Strategy Note identified the key challenges facing the passenger transportation sector and, combined with the work undertaken in the current study, they can be summarised as:

- The passenger transport supply has been regulated by a traditional system with roots many years back in history.
- The regulatory system which previously functioned reasonably well is now inefficient and outdated.
- Public transport in WBG is performing inefficiently
- As a consequence the traditional bus system is not functioning as it used to.
- Many permits for taxis and shared taxis have been issued (and in excess of the traditional rules) in recent years
- The current situation is not stable, and some operators will likely go out of operation
- There are several contributing factors many of which have its roots in measures taken by the Israeli administration, including
    - the closure and movement restriction regime and resultant delays at checkpoints;

  - the loss of direct access from north to south through Jerusalem especially with the inadequate bypass alternative
- Moreover, the poor condition of the road network is causing significant increase in operational and maintenance cost.
- Enforcement mechanisms have also been broken down
- Illegal taxis proliferate in the urban and peri-urban areas, with little regard for public safety or basic road etiquette.

This is a complex set of problems, many of which are interlinked. The division of responsibility between the Palestinian and Israeli administrations makes problem-solving more difficult, not least because priorities are different.

4. Passenger Transport Services in West Bank and Gaza

Passenger transport services in West Bank consist of the following main types:

- Inter-city scheduled bus services (all operating entirely within the West Bank, as services to other countries, to Israel, to East Jerusalem, and most recently to Gaza have been systematically suspended over the years)
- Urban scheduled bus services in Nablus and Hebron
- Local bus services connecting towns and villages to the main urban centres, nominally operating on regular basis, but more typically operating on a 'fill and go'
- Minibus services connecting towns and villages to the main urban centres, nominally operating on regular basis, but more typically operating on a 'fill and go'
- Shared-taxi services which should operate on specific routes
- Taxis for individual hire

Normal bus services have completely ceased in Gaza, although some services continue to bring children to schools.

There is also substantial provision of other services in the West Bank which range from violation of the permit conditions through to outright illegal activity:

- Shared taxi services extracting from bus and minibus routes, and operating off-route
- Taxis licenced for individual hire operating shared-taxi type services
- Private citizens using their cars to offer illegal taxi services

In practice, each of these illegal types of operator is improperly extracting revenue from authorised operators, motivating them in turn to behave improperly and extract from others. One of the critical requirements is to enforce the regulations and make each category of operator stay within his authorised service type.

The volume of passenger transport services has declined. Within the West Bank, service levels have dropped to fractions of their former levels. Nonetheless, most authorised routes still continue to provide a basic level of service, albeit reduced. Most routes which have closed entirely have done so due to the difficulty to operate caused by road closures and other restrictions. All bus services to destinations outside of the West Bank had ceased by 2000.

Intercity bus services have lost a substantial portion of their business to shared-taxis, due to the delays and variability at checkpoints – people have learned that there is less likelihood of a long delay when travelling on a vehicle with much less people. Consequently, the bus routes have had to reduce their service levels.

4.1. Transport Operators

Transport Operators in the West Bank and Gaza are mostly family-owned and run along traditional business lines. They are typically small companies, and are as likely to finance fleet renewal and operations through traditional means of raising capital as through bank loans or share subscription.

In recent years, the operators have been under extreme financial pressure, suffering losses for many years in succession, and depleting their capital base and reserves. As a result, a number of operators have ceased operations, and many more have limited ability to continue for much longer. Table 1 shows the scale of the schedule bus transport industry in terms of numbers of operators, routes, and buses. It also shows how many are still operating and how many have ceased.

	Total Registered	**Operating**	**Not operating**
Registered Operators	86	76	10
Registered Routes	154	128	26
Registered Buses	723	594	129
- Large buses (>25 seats)	*355*	*284*	*71*
- Small buses (up to 25 seats)	*368*	*310*	*58*

Source: PNA Ministry of Transport (2008)

Table 1: Number of registered operators, routes and buses in West Bank

Table 2 shows the distribution of operators by size. This shows that there are currently only 6 companies operating 20 or more buses, and that the 16 companies with 10 buses or more account for 55% of the market.

Number of Buses	**Number of Operators of this size**	**Total Buses on Registered Routes**	**Cumulative total**
40-49	1	42 (7%)	42 (7%)
30-39	1	37 (6%)	37 (13%)
20-29	4	107 (18%)	144 (31%)
15-19	5	82 (14%)	251 (45%)
10-14	5	56 (10%)	324 (55%)
10 buses or more	*16*	*324*	*55%*
5-9	30	169 (28%)	493 (83%)
1-4	30	103 (17%)	594 (100%)
0	10	0 (0%)	594 (100%)
Grand Total	*86*	*594 (100%)*	*594 (100%)*

Source: Ministry of Transport (2008)

Table 2: Scale of Bus Operators in West Bank

It is worth noting that some of these companies had significantly larger fleets when they were able to operate long-distance buses to Israel, Lebanon, Egypt, Jordan, Syria, and Saudi Arabia (especially for Haj and other religious visits). The loss of this profitable business hit some of the main companies very hard, and they have never recovered from it.

4.2. Productivity of the Transport Operators

Productivity is low due to the many factors described above. As part of the current study the productivity was examined of the transport services and operators in Nablus and Hebron, the two main urban centres on the West Bank. The key metrics are shown in Table 3 below.

	Nablus Buses	**Hebron Buses**	**Nablus Shared Taxi**	**Hebron Shared Taxi**
Vehicles in daily service	60%	60%	90%	113%
Trips/vehicle/day	4.2	3.2	17.9	11
Kms/vehicle/day	61	91	103	116
Passengers/vehicle/day	113	120	84	89
Revenue/vehicle/day (NIS)	380	407	203	243
Operating speed	25	30	26	26

Notes:
1) Includes all services operating within, and to/from, Nablus and Hebron
2) Only routes/buses actually in operation included
3) Passengers and revenue estimated for shared taxis; includes only authorised shared-taxi services

Table 3: Productivity measures of bus operators in Nablus and Hebron

It is fully understood that conditions in West Bank and Gaza are not normal. Nonetheless:

- Bus Utilisation (3-4 trips/day) and Output (<100 km/day) are low by any standards
- Passengers per vehicle (~120/day) and revenue per vehicle (NIS 280-400 (<$100)/day) are low by any standards
- Only 60% of the registered fleet is in service (example of Nablus and Hebron)
- Buses are being withheld from service even on active routes, due to the reduced business

Discussions with both the association of operators and with individual operators indicate that the productivity measures in Nablus and Hebron are a reasonable reflection of the industry across the West Bank.

4.3. Fleet Condition and Renewal

The decline in fleet condition and increase in average vehicle age have been direct consequences of the loss of profitability and reduced financial capacity. Very few new vehicles have been acquired since 2000, and a large proportion of the fleet age now exceeds the permitted maximum (but are reluctantly tolerated since currently the only alternative would be to close services).

For the large bus fleet, as shown in Figure 1 below, some 30% of the vehicles are more than 16 years of age and 80% are 12 years or older. Only 6 new vehicles have been purchased since 2000.

In developed economies, urban operators typically replace their main fleet at 10-12 years and inter-urban operators on the main routes replace their vehicles even earlier. Even though there is residual life remaining in the vehicle, the costs of maintenance tend to increase sharply after that age. The operators can also benefit from newer technologies, better fuel efficiency, better reliability, maintenance cost savings during the initial warranty period, and a superior quality product for their customers.

In West Bank, almost the entire large bus fleet has already entered the phase at which they would be replaced elsewhere. In fact, many of the more recent purchases have been second-hand Israeli buses which have reached the end of their economic life there, and are sold on to the Palestinian operators who utilise the residual sub-economic technical life.

For the smaller-bus fleet, shown in Figure 2 below, a similar profile applies, allowing for the shorter life of such vehicles.

This is an extreme investment deficit that urgently needs to be filled, and has resulted in a large life-expired fleet that faces imminent collapse. Fleet renewal is the greatest crisis facing the bus sector.

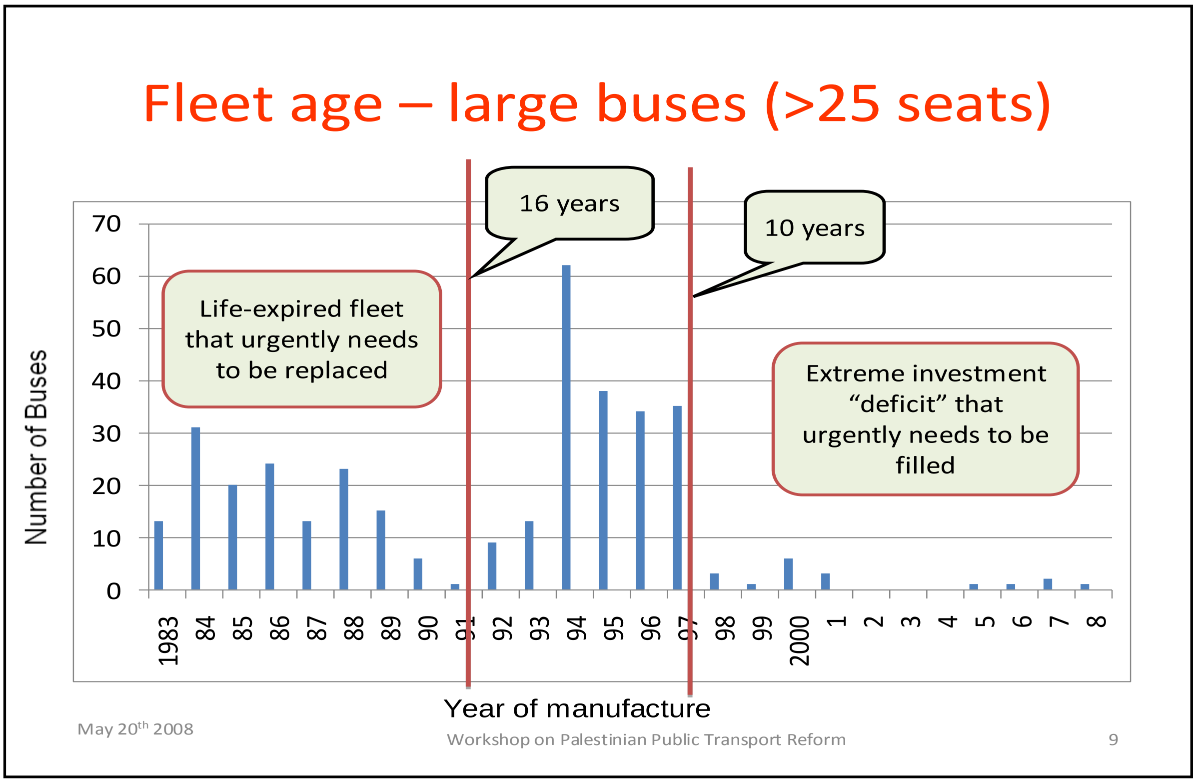

Figure 1: Distribution of year of manufacture of Large Buses in the West Bank

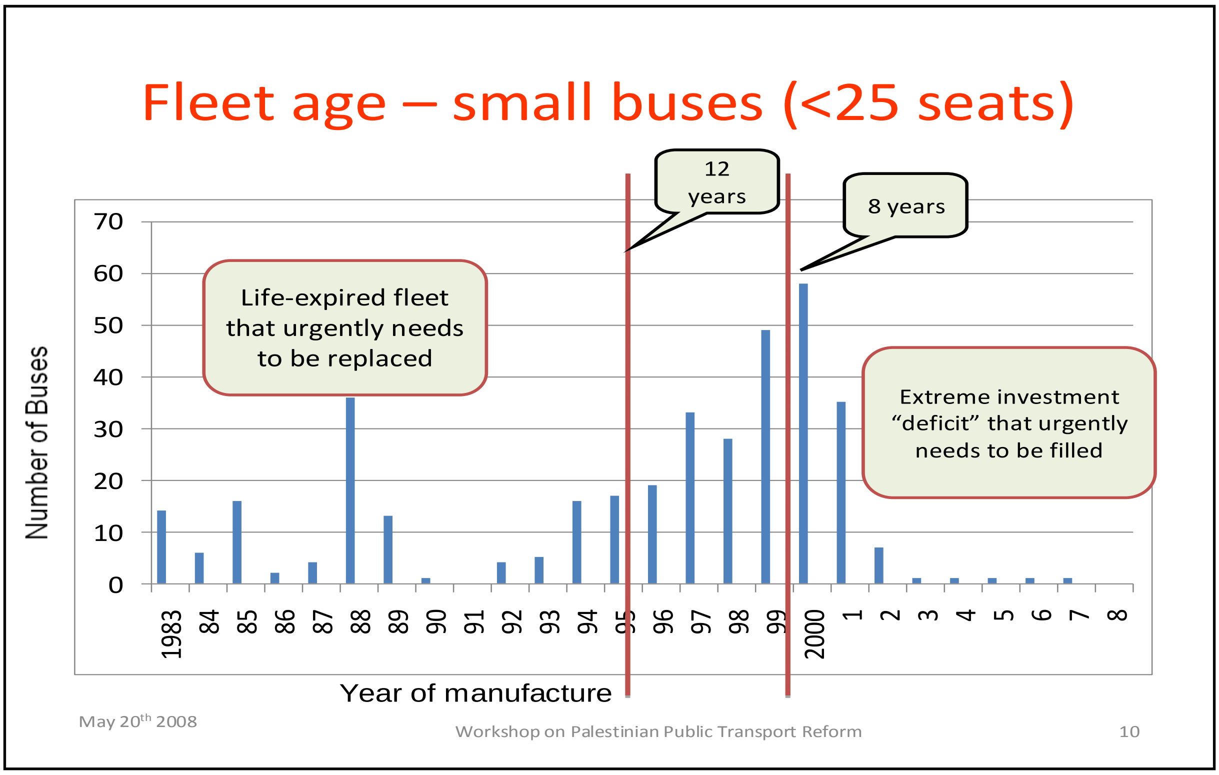

Figure 2: Distribution of year of manufacture of small buses in the West Bank

4.4. *Financial Capacity and Sustainability*

The current study studied the costs and revenues of a number of bus operators on the West Bank. Coupled with the assessment of capacity and productivity, and the meetings with the operator sector, the following main conclusions were drawn:

- Revenue per bus is barely sufficient to cover direct operating costs (fuel and maintenance consume 60+% of incomes)
- For most operators, surpluses are not being generated to finance fleet replacement or proper maintenance
- At current productivity levels, operators can keep going with depreciated buses for the remainder of their workable life, but cannot replace them
- By implication, reserves are being exhausted, many of the existing companies face eventual collapse
- The *status quo* can continue for a while longer, but not for ever

The key finding is that the bus sector is unsustainable as it currently stands.

The purpose of the current actions is to find ways of restoring stability to the sector and, political conditions permitting, to re-establish an effective transportation capacity. Consideration was given to the requirements for sustainability for the sector. These are summarised as:

- The sector is unsustainable unless fleet renewal can be financed

- To finance new vehicles, operators must generate sufficient surpluses over a sustained period
- This requires a major change in productivity:
  - Substantially increased asset utilisation and yield
  - Buses must operate more kms., more hours, more trips
  - Passengers and revenue per bus must increase
  - More efficient routes and deployment practices
- In turn, this will require business changes both within companies and across the sector

5. Potential for Improvements and Efficiencies

Consideration was given to where improvements could be made. It is clear that any single-strand approach will be insufficient, since there are many institutional issues that should also be addressed. The key areas identified for improvement are:

- Institutional Level
  - Market framework and regulation
  - Organisation of the passenger transport services
  - Network strategy and overall design
  - Enforcement

- Operators Level
  - Company organisation and structure
  - Consolidation of business units for greater efficiency
  - Business and management practices
  - Network and route optimisation
  - Asset productivity
  - Common promotion and marketing

- 3rd Party
  - Access to finance

At a more detailed and practical level, the potential for efficiencies was examined since this is where cost savings and greater productivity needs to be achieved. The main potential areas are:

- Restructuring of the network
- Greater use of interchange – 'spoke and hub'
- Rescheduling of clusters of routes
- Choice of bus size
- Choice of bus fuel and fuel consumption efficiency
- Standardisation of bus models and maintenance practices
- Asset assignment
- Personnel rostering
- Combined higher-order services

However, many of the potential efficiencies cannot be achieved under the current structure and business practices of the traditional operators. They are too fragmented, and are too deeply linked to their individual routes.

They will need to consolidate into larger units. The potential advantages of consolidation are:

- Improved efficiency of assets
- Increased financing capacity
- Opportunities for new business and operations management practices
- Economies of scale and capacity to afford better equipment
- Improved deployment, scheduling and rosters
- Improved marketing and promotion

6. Strategy Concept

During Missions in March and May 2008, the Bank has identified a strategy for restoring the sector. This has been shared with the Ministry, and subsequently with the operator sector and key municipalities at a workshop on 20th May 2008.

The basic principle is to achieve consolidation among the small operators into companies of sufficient size to achieve network, organisational and operational efficiencies, and to restructure their businesses to be able to generate surpluses after expenses. This would provide the capacity for asset renewal. To encourage the consolidation of operators and network, and to protect the revenue streams, exclusive franchises for geographic areas would be granted to the consolidated companies.

The Strategy consists of four main strands:

5) *Offer Area Concessions for the fixed-route passenger transport services to competent transport operating companies*. The Area Concessions would be for specific geographic areas in West Bank and Gaza (e.g. a city or Governorate) for a specific period of time with possibility of renewal subject to satisfactory performance. The Concessionaire would define the specific services within parameters set down by the Ministry of Transport.

6) *Facilitate the existing operators to form legal entities* that can bid for and operate the area concessions to a high standard over the concession life. The encouraged option is to merge existing companies into a new business, but other forms of affiliation could be acceptable as long as they have legal form and proper accountability.

7) *Assist operating companies to acquire vehicles and depot/maintenance facilities* either by establishing a bus leasing company or by making suitable financing channels available. A bus leasing company would acquire a suitable fleet of large and mid-sized buses and make them available on long-term lease to the holders of the Area Concessions.

8) *Facilitate the establishment of a support services company* which would provide terminals, customer-facing services, ticketing, passenger information in a common way throughout West Bank and Gaza. It would also provide higher-order business services for the operating companies, such as network planning, technical research and know-how transfer.

Following the workshop and feedback from the stakeholders, the Bank has carried out further studies to collect and analyse data about the services and operators, and has prepared more detailed working notes in the main strands of the Concept. The following section of this report deal with these strands:

- The Area Franchise concept
- Consolidation of the operators into suitable companies or other legal entities
- Finance and Bus Leasing Company
- Adapting the regulatory framework
- Restructuring of the Public Transport Department at the Ministry of Transport

7. Area Franchises

The Area Franchise concept is designed to provide a stable business and revenue environment for the operator, who has the opportunity to optimise his revenue and costs, in return for meeting the mobility needs of the Area.

The outline approach was presented to the Operators at the May workshop. The general feedback from the Operators was that they would give serious consideration to any initiative that would strengthen their sector, but they would need to understand the details of the proposals, and what it would mean for their businesses. One specific request was to have a clearer picture of the Area Franchise and how it would work. The Bank has responded to this request by developing a detailed working note on Area Franchises. The note addresses two main issues:

1) The principles of an Area Franchise are set out. The key issues arising in the design of the Franchise are explained in detail in the working note, and are shown in summary in Section 7.2. These are :

- The unit of the Franchise
- The boundaries of the Franchise
- The Service Types included in the Franchise
- The level of Exclusivity granted to the Franchisee
- Allocation of rights in relation to Network Design
- Who sets the Tariffs
- The financial basis, and whether the franchise should be self-financing
- Duration of the Franchise
- Requirements in relation to vehicle procurement
- Rules for sub-contracting
- Quality standards

2) A worked example is presented in Section 3. This takes the Nablus and Tulkarem areas as the example Area, using data collected and analysed by the Bank during mid-2008.. It sets out the following information:

- Geographical Area of the Franchise
- Scope of the passenger transport services
- Passenger transport services to be provided
- Service parameters
- Estimated volume of service provision
- Performance conditions
- Eligibility criteria for Franchise companies

The details of the worked example are provided purely for discussion purposes. The actual implementation of an Area Franchise may be different to the example presented here.

7.1. *Summary of Model Franchise design features*

FACTOR	REF		OPTION
Unit of Franchise	1c	Area	All services in a geographic area would be offered in one bundle
Geographic scale	2a	Governorate level	The franchise would be for the size of an individual Governorate, or two if this is justified. Boundaries might be adjusted to meet local circumstances
Services Types included in the Franchise	3b	All bus and minibus services in the franchise area	All urban, peripheral, village and other bus and minibus services within the franchise area
	3e	Include intercity buses	Option 3b, with the intercity buses which are traditionally associated with operators in the franchise area
Level of Exclusivity	4b	Right of first refusal	The authority may only authorise other operators where it has first offered the franchisee the option to provide the service within the framework of the franchise, and on similar terms and conditions as any other proposed operator.
Network design	5b	Authority sets broad parameters	Authority sets transport objectives, franchisee has freedom to optimise and innovate
Tariff setting	6b	Set by Formula	The initial tariff is reviewed at agreed intervals, using a formula that takes in to account variations in the cost of inputs and business levels
Financial Basis	7a	Self-financing	The Franchise must be operated on a profitable basis
	7b	Reimbursement for special categories of passengers	Authority pays Franchisee for the revenue loss from discounted /free travel
Franchise Duration	8b	Medium term with renewal	A set of performance criteria would be set. If the performance is above target over the period, a renewal for a further 5 years would be offered. If performance is not above target, a new call for tenders would be issued.
Vehicle Procurement	9c	Special purpose leasing company	Special-purpose bus leasing company is established to make vehicles available to the Franchisees across the West Bank.
Subcontracting	10b	Village services only	Franchisee must operate all urban, peri-urban and intercity services directly. It may use named affiliates to operate specific village services on a permanent basis, where the vehicle is parked overnight at the village to minimise out-of-service operations.
Quality Standards	11c	Continuous Improvement	Authority sets initial standards with modest values, within a continuous improvement framework. Standards are progressively raised over the franchise life, taking into account the readiness of the Franchisee.

7.2. Sample Franchise for Nablus and Tulkarem

A Sample Franchise is prepared using the above principles to illustrate the dimensions and probable conditions for a franchise.

7.2.1. Geographical Area of the Franchise

The Franchise is offered for an area approximating the Governorates of Nablus and Tulkarem, the precise boundaries to be finalised with the authorities concerned. The urban areas of Nablus and Tulkarem are included.

7.2.2. Scope of Passenger Transport Services

The Franchise is for all bus and minibus services operating within the Franchise Area, i.e. within the urban areas, villages and rural areas of Nablus and Tulkarem Governorates.

Bus and minibus services which operate within the Franchise Area and also into contiguous areas will be included in the Franchise on the following basis:

- Services which have traditionally been provided solely by operators in the Franchise area will be included in the Franchise
- Services which have traditionally been provided solely by operators outside the Franchise area will not be included in the Franchise
- All other existing services will be operated on a shared basis with the holders of other Franchises, in principle *pro rata* to the percent of the route length within the Franchise areas
- New services will be operated on a shared basis with the holders of other Franchises, in principle *pro rata* to the percent of the route length within the Franchise areas

Shared taxi and private hire taxis are not included in the Franchise, and will continue to operate independent of the Franchise.

7.2.3. Passenger Transport Services to be provided

The Franchisee is required to design the network and service levels for the Franchise Area, subject to the Service Parameters described in this section.

The Franchisee will submit a proposed Service Plan to the Authority prior to commencing services. This will include information, including maps, about the routes, the service level and the vehicle type to be used on each route. The Authority will review this to ensure that it is compliant with the Service Parameters (see below).

The Franchisee may adjust the Service Plan from time to time as it sees fit, always provided that it is submitted in advance to the Authority to check compliance with the Service Parameters.

At commencement of the Franchise, the Service Plan must provide a complete network for all bus and minibus services in the Franchise Area. At a minimum, this must provide a comparable service and coverage to that which is currently in operation.

By end of the second year, the Service Plan must include services which replace shared taxis. The Authority will authorise such services, and will assist the Franchisee in the displacement of the shared taxis concerned by means to be agreed. If it chooses, the Franchisee may do this at Franchise commencement or at any stage prior to the end of the second year.

After the end of the second year, the opportunity for organised displacement of shared taxis will be closed and any further such routes will have to be operated alongside the shared taxis at the Franchisee's financial risk.

7.2.4. Service Parameters

The following Service Parameters are the minimum requirements for the Service Plan in the Franchise Area. The Franchisee may provide services in excess of these requirements as it sees fit, except in the case of inter-Franchise routes where it would infringe agreements on route-sharing.

- All parts of the urban areas of Nablus and Tulkarem must be served
- All villages must be served at least one route which either:
  - Provides a direct link to Nablus or Tulkarem; or
  - Connects to a service with a direct link to Nablus or Tulkarem where the passenger does not have to pay a tariff higher than if there was a direct route, and does not have to wait longer than 10 minutes for the transfer
- First trip on all routes must operate no later than 0600
- Last trip on all routes must operate no later than 1900
- Services in urban areas must have the following maximum service intervals:
  - Peak hours: not more than 15 minutes
  - Off-peak hours: not more than 30 minutes
- Services from villages and rural areas must have the maximum service intervals:
  - Peak hours: not more than 30 minutes
  - Off-peak hours: not more than 2 hours
- Large buses must be used except where the Franchisee demonstrates that the demand does not require it, or the route is unsuitable for large buses
- Where there are verified ongoing cases of supply exceeding demand, and passengers being unable to board either the first bus or another bus within 10 minutes, the Franchisee must increase the service level to meet the demand.

Exceptions to these parameters may be proposed on a case-by-case basis, accompanied by explanation. Examples include services which are primarily provided for schoolchildren, or which have seasonal users (e.g. universities).

Temporary exemptions will be provided for areas where road closures and security restrictions prevent reasonable access to the area. In such cases, once reasonable access is restored the Franchisee will be required to provided adequate service.

7.2.5. Estimated Volume of Service Provision

The service is estimated to initially require 120 buses, of which at least 65% would be large buses.

The estimate is made on the following basis:

- There are currently 90 buses operating (of 146 authorised) on 22 active routes (of 37 authorised) operating in and serving Nablus, including the route from Tulkarem to Nablus.
- A further 20 buses are used on intercity routes operating from Tulkarem and not included in the Nablus figures
- A further 10 buses are required for local Tulkarem routes that do not serve Nablus

The volume of service is estimated at 12,000 vehicle-kilometres per day, based on operating 100 kilometres per bus per day. For comparison, current operation on Nablus routes is about 60 kms. bus per day. An intensification of the current service is expected.

By end of year 2, the service is estimated to require 170 buses, of which at least 60% would be large buses. This increase of 50 buses is expected to result from routes opened or strengthened to displace shared taxis where buses would provide a more rational service. There are currently about 1150 shared taxis operating on Nablus routes. It is expected that about 30% of these (330) would be displaced, and using an approximation of replacing 6 shared-taxi with one bus, about50 additional buses would be required.

By end of year 2, the volume of service is estimated at 17,000 vehicle-kilometres per day, again assuming 100 kilometres per bus per day.

The Franchisee may operate a higher volume of service where it chooses to do so.

The above estimates do not make provision for the requirements for increased coverage or service levels if the current restrictions on mobility within the West Bank are eased or removed. This would lead to a significant increase in the vehicle-kilometres operated, but is not expected to require much increase in the number of buses since the productivity would improve with less time spent at checkpoints and higher operating speeds.

7.2.6. Performance Criteria

The Franchisee will be required to provide services in accordance with the following performance criteria:

- A minimum of 98% of all scheduled services must be operated.
  - Any trip that does not operate within 15 minutes of its designated time is deemed to have not operated.
  - Any trip not completed due to vehicle breakdown is deemed to have not operated.
- All designated first and last trips must be operated, without exception. It is the responsibility of the Franchisee to have standby arrangements in case of operational problems.
- The average age of the buses utilised on the Franchise must not exceed 6 years
- No bus exceeding 12 years in age may be used on any of the Franchise services, other than in case of verifiable emergency
- All vehicles must have current certificate of roadworthiness, and be properly insured
- All drivers must have current and appropriate driving licences
- All vehicles fielded must be in proper internal and external condition and clean
- All drivers fielded must be fit for service
- All services must be operated within an organised operations management system

7.3. Eligibility

Franchises would only be granted to entities which comply with and can verify the following:

- The Franchisee must be a legal entity, of a form that may enter and be held liable for Contracts
- All vehicles must be either owned or taken on long-term lease by the Franchisee
- All operating staff, including drivers, dispatchers and management, must be employees of the Franchisee
- The Franchisee must either own or have access by long-term formal Contract to maintenance facilities which are suitable to maintain the vehicle types used for the Franchise, and which have adequate fuelling, washing and support facilities
- The Franchisee must have proper operations management, accounting and business management structures, and adequately qualified senior persons
- The Franchisee must have the financial capacity to acquire the vehicles and operate the services, and must be in compliance with corporate and tax obligations.

It is permitted to sub-contract village services, where the vehicle is kept at the village overnight for practical operational reasons, providing that the total sub-contracting does not exceed 10% of either the buses used or vehicle-kilometres operated.

In the proposal phase, Proposers will be required to give an undertaking that they comply with the above conditions, and to verify all aspects prior to being invited to sign the Franchise Contract.

7.4. Implementation and Supporting Actions required

The implementation of the Area Franchises will require the following actions:

- Formal decision by the Ministry of Transport to proceed with Area Franchises
- Consolidation of the Operators into entities capable of entering the contracts for the Area Franchises, and capable of mobilising and managing the operational resources
- Revision of the regulatory framework to provide the basis for the Area Franchises
- Termination of the existing route operating permits
- Preparation of the specifications and agreements for the Area Franchises, including service parameters and performance criteria, and appropriate incentives
- Restructuring and capacity building of the regulatory and monitoring unit at the Ministry of Transport, or establishment of appropriate regulatory capacity at another agency
- Acquisition by the bus operating companies of the necessary bus fleet and support facilities

It would be possible to establish the Area Franchises within about two years from a decision to proceed (e.g. 1st January 2011), on the basis of:

- one year (2009) to design the Area Franchise scheme, to put in place the regulatory framework, to establish the regulatory capacity, and to consolidate the operators
- one year (2010) to design the Area Franchise networks, to negotiate the Area Franchise contracts, to mobilise the physical and human resources, to and acquire vehicles, and to establish the operations and business management structures and systems

8. Consolidation of Operators

The existing operators will need to form into entities that can enter into contracts and take on service and financing obligations.

Three levels of consolidation are possible:

Association

- This is based on voluntary co-operation and some co-ordination
- It has no legal status, and there is no binding contracted obligation among the participants
- There is no change to companies, identity, or allocation of resources

'Legal' Union

- This has a quasi-legal status, it could be formalised by a written binding agreement among the operators
- This permits more rational operation of routes and more rational allocation of resources
- The operators retain their identities, there is no consolidation of assets or finances

Consolidated Company

- A new company is formed, the existing operators are shareholders
- Operations transfer to the new company, the existing companies cease to operate on the service routes (but they could continue to do other work)
- Relevant assets are transferred, and new equity and assets are sought

Two concepts are currently under consideration, since Associations will not be sufficient to provide either the benefits or the level of commitment required:

a) Formation of three Unions of bus operators (North, Central, South), as proposed by the Ministry of Transport. Each Unions would have a legal basis, a Board of Directors, and a professional management. It would operate in a co-operative way, but the identity of the companies would remain distinct and their assets would not be integrated.

b) Consolidation of the bus operators into new companies in which the assets of the companies would be combined, and the original identities would be absorbed. The new company would plan and organise all of the services to meet passenger demand and with optimal allocation of resources.

Consolidated Companies are necessary for Area Contracts and for long-term lending and investment, but there are concerns among the operators about this approach, including:

- the current willingness of operators to participate and to give up their identities and historic operating permits
- the difficulty to evaluate the assets
- the difficulty and time taken to dissolve the existing companies and form the new ones

A transition approach is needed, beginning with Unions – to which the Operators have now committed – and within a period of about 2 years to evolve to Consolidated Companies.

8.1. Union of Bus Companies

The 'Union' concept is closer to a 'Co-operative' where there is close and integrated working than an 'Association' (which is a much looser arrangement with less commitment).

The main elements of the Unions, as proposed by the Ministry of Transport, are:

- They would be legal entities (this needs to be verified by the Companies Controller)
- The Union would have a Board of Directors consisting of the Bus Operators and other nominees
- A well qualified CEO would be appointed along with other professional staff, these would not be the current bus operator managers
- Modern administration methods would be implemented
- There would be no transfer or consolidation of property or assets
- Lines would be shared between the companies of the union, but each company would continue to collect its own revenue
- To the extent permitted under the current permit rules, opportunities would be sought for more rational operation of routes and allocation of resources
- The Union would help to enhance services on the ground, e.g. in terms of schedules, opening of new routes, and this would lead to increased ridership and profitability
- The Ministry of Transport would issue rules and regulations about how to make the Unions legal, and how they should structure their internal affairs
- The Ministry of Transport would provide incentives and monitoring
- This is seen as a transitional phase of about 2 years, during which the operators would see the benefits, and then they would move to consolidation

The advantages of this scenario are:

- It can be organised quickly, and the majority of Operators have already signed a declaration that they would accept it
- It defers the issues of consolidation, identity, asset validation, and operator resistance
- Operators can join without making permanent commitment
- Operators keep their identity and operational freedom

However, it also has some potential limitations which need to be addressed:

- The Union must stay with the existing route structure, since the current regulatory framework does not permit doing otherwise. This prevents gaining efficiencies from network redesign.
- Companies retain their own identities and operations. This will limit the possibility for comprehensive operational and organisational efficiency gains.
- It is not yet clear how the Union will make the expected service improvements or efficiency gains, and hence whether the Operators will be convinced of the benefits of future consolidation based on the benefits they receive during the Union phase.
- The CEO and professional staff are not from the Bus Operators. It is not yet clear what skills they will bring and whether they will have the necessary transport-sector expertise.
- A long-term Area Franchise could not be undertaken by such an entity.
- The ability to raise capital or have access to investment/loan funds will be limited.

Two recommendations are made:

1) Develop a strategy, business plan and implementation plan that sets out clearly:

- Targets and achievements that are expected from the Union,
- Actions will be implemented to achieve them, including network and service improvements
- Supporting or enabling actions are required from the Ministry of Transport and others
- The financing plan

The Charter of the Union, the organisational structure, and the agreement among the participating operators should be based on the business activities.

2) Within the first months of the Union's existence, develop the Migration plan from the Union to a Consolidated Company. This would:

- Use the Transition Period to plan and the business of the Company
- Design the structure and shareholding of the new Company
- Prepare the Business and Financial Planning
- Identify the funding requirements and potential sources
- Deal with the difficult issues of negotiation among the participants and future shareholders

Consolidated Companies

Consolidated Companies are needed for Area Franchises, and to take on the heavy financing burden of fleet renewal. Two serious concerns have been expressed:

1) How to form new companies and manage all of the existing operators.
2) How to value the assets of the existing companies.

8.1.1. Formation of New Companies

The Consolidated Companies should be formed as new entities, independent of the existing companies. There is no obvious reason why formation of the new companies requires the existing companies to be wound up. The existing companies could remain in business offering services other than scheduled bus routes – e.g. private hire, schools services, etc. – and hopefully it will not be too long before they could once again engage in services to Gaza, Israel and neighbouring countries.

It is recommended to decouple the issues of asset valuation, dissolution of existing companies, or linkage of property between existing and new companies, from the formation of new companies.

While the Consolidated Companies are expected to be drawn from the owners, leaders and capital of the existing bus operators, they should be new and independent entities. They will establish their own capital base, and they will have no historic debt or liabilities. They will establish their own operating, management, administrative and financial capacity. Of course, this may come from the capacity and assets of the existing operators, but such inputs will be seen as investment in the new company independent of the original existing company.

The Consolidated Companies must be awarded an Area Franchise in order to have operating rights, and the total of their operating rights will be what is permitted under the Area Franchise(s).

The following mechanism is proposed for the formation of a Consolidated Company:

- An Area is designated for an Area Franchise
- Where either the Union for the Area, or a grouping of operators who provide 67% or more of the current bus supply in the Area make common application in writing, their proposal to be awarded an Area Franchise will be considered by the Ministry of Transport
- If the Area Franchise is awarded, then the Consolidated Company (CC) may be formed
- The CC will be awarded the exclusive operating rights for bus and minibus services in the Franchise Area (except where there is agreement for shared Inter-City routes)
- All existing operating permits will be terminated from the date of commencement of the Area Franchise, thus all existing operators will cease to be permitted to operate
- All existing operators will be offered a shareholding in the new CC, as described in section 8.1.2 below, reflecting the number and type of buses they currently operate, and weighted by the strength of the route.
- This shareholding offer is free, operators may choose to accept it or decline it. Operators who accept it will have permanent protected shareholding, and would be eligible for position on the Board according to the applicable rules.
- Operators who decline their shareholding offer may, entirely at the discretion of the CC, be offered a subcontract for a period of 3-5 years. This is limited to village-based services, and collectively all such sub-contracts may not exceed 10% of the overall CC service.
- All other operators who decline to take up their shareholding offer will have no future participation in the company and have no right to compensation. However, the CC may, entirely at its discretion, make a goodwill payment.

8.1.2. Valuation of Assets of Existing Companies

It is strongly recommended to value only the Assets (as described below), and not the existing companies themselves.

The Assets can be considered in three categories:

1) Recognition of the current operations of each existing operator in the Area, bearing in mind that the operating right is legally vested in the Ministry of Transport and the operator is allowed to operate under renewable permit. This would be done on the basis of the number of buses currently fielded, and weighted by size of vehicle (large/small) and the relative financial strength of the route. Thus, each of the existing operators would receive a ‘weighted score’, being their adjusted percentage of the total supply in the Area.

2) Tangible assets *which would be used by the new CC*, including items such as land, premises, vehicles, parking, maintenance facilities, washing and fuelling facilities, equipment, parts, operating and management systems. Human assets such as managerial and specialist skills could also be included, but drivers/conductors would not since they are already reflected in the vehicle count. The assets would be valued at their market/sale value, and assets not transferring to the new CC would not be counted (they can still be used or sold by the existing companies).

3) Cash investments in the form of equity.

The transfer of any assets from existing companies should be entirely at the discretion of the new CC. The CC will be a large company using renewed fleet, possibly much of it will be new vehicles, with modern maintenance facilities and modern business methods. It is a hard fact that much of the current tangible and intangible asset base will not be usable by the new CCs.

The operating permits themselves would not be considered as assets, since they are not the property of the Operators.

The initial shareholding of the company would be distributed across these three categories according to an agreed formula. It is recommended that Category 1, the recognition of existing operations in the Area, is set at a minimum of 50% of total shares. In other words, the existing operators get at least half the shares for free in return for the extinguishing of their historic operating rights.

The remaining shares should be available in return for investments in the form of Category 2 (assets) or Category 3 (equity). Cash made available as loans or other repayable instruments would not automatically be entitled to shares, but for large loans a shareholding could be given *gratis* at the discretion of the CC.

Example (for illustrative purposes only):

An Area is currently served by 100 buses, of which

- 30 are large buses on profitable routes, weighted as 1.5
- 40 are large buses on marginal routes, weighted as 1.0
- 30 are small buses, weighted as 0.5

Operator A currently operates 10 large buses on a profitable route, 10 large buses on two marginal routes, and no small buses. The weighted score is:

(10*1.5) + (10*1.0) + (0*0.5) = 15 + 10 + 0 = 25

The shares of the company will be allocated as follows:

- 60% for the operating strength of the existing operators
- 10% for the assets transferred from the existing operators
- 30% for equity investments

Operator A's vehicles are old, and will not be used by the new CC. He will not invest cash as equity in the company. His offer of shareholding will therefore be:

60% * 25 = 15% of the total shares of the company, received free of charge.

9. Financing Fleet Renewal and Bus Leasing Company

As described in Section 4.3 above, most of the fleet is in the later years of useful service, and much of the bus fleet would be consider life-expired in most other countries. There is an urgent need to replace a large proportion of the fleet within the next 2-3 years, otherwise it will cease to operate and the business will be lost to shared-taxis and personal transport.

The priority is to replace the large bus fleet, since these provide the greater part of the capacity. However, new vehicles are expensive to procure and they cannot share parts or maintenance with other vehicles (unlike minibuses which have the same chassis, engine and gearbox as commercial vans which are available in the West Bank).

A strategic decision needs to be taken (or it will occur by default) on whether to:

a) Systematically replace the life-expired fleet with new buses over a 3-5 year period, so that the fleet has been rehabilitated and the quality substantially improved; or

b) In order to save funds, replace life-expired vehicles with the 12-year old Israeli buses and work them to the end of their technical life.

The Bank recommends strategy (a), replacement with new buses, even if this has to be done over an extended timescale due to limitation of available funds. The remainder of this section is based on the assumption that the fleet will be renewed.

Depending on the vehicle type selected, the cost of a standard urban 12 metre bus can range from $70,000 to over $300,000. Keeping in mind the requirements to conform with Israeli specifications, the need for durable buses, and the limits on the price that operators can afford to pay, the purchased vehicles are likely to be in the cost range of $100,000 to $150,000.

This means that the investment requirements for large bus replacement are in the range $40-60 million over the period 2009-2012. Maintenance facilities and supplies of spare parts are additional. It will also be necessary to invest about $20 million to renew the small bus fleet over the same period.

The big challenge is to develop options for financing the fleet renewal, at costs that the operators can afford and without excessive risk. This section considers the main options, and then develops the concept of a Bus Leasing Company as a means of making vehicles available to the operators without the need for them to have access to the investment funds.

9.1. Financing Options

Four options have been identified to finance new vehicles:

- Operators buy buses using their own resources or through commercial loans
- A special financing channel is made available for operators to buy buses
- Inward investment is made into the bus operating companies in return for shareholding, this provides the finance to buy buses
- Operators lease buses

Each of these options is discussed in turn. A more comprehensive exercise is required to calculate the costs to the operators of each option, considering:

- Upfront costs
- Requirements for collateral
- Regular repayments, as well as any risk or other insurance requirements
- Lifecycle costs
- Asset ownership and value at termination
- Feasibility in the Palestinian context

For all options, lenders or investors will only be interested in companies that can show a credible business proposition, an ability to repay, sound financial forecasts, and the organisational capacity to perform and manage their business effectively. The bus operating companies will need to prepare good quality business and financial plans. They will also need to strengthen their organisational and financial structures to give confidence to potential lenders or investors.

For all options, it is to the advantage of the operators to standardise the bus manufacturer and models to a small number of types, and to purchase collectively. This will have the following key advantages:

- The purchase cost per vehicle will be significantly reduced
- The costs of spare parts will also be significantly reduced as they can be purchased in bulk, and there is less risk of a vehicle being grounded while awaiting supply of critical parts
- Maintenance practices and equipment will be harmonised, leading to better quality, reduced costs and reduced turnaround time.
- The bus supplier will have greater commitment to their Palestinian bus industry customers, and will have the business justification to establish agents and technical support in-country

9.1.1. Operators Buy Buses using own resources or loans

Operators can buy buses independently. In the current situation, none of the operators have the possibility of using their own resources to purchase new large buses.

Operators would need to take loans from commercial banks or other financial institutions. If there are three Area Franchises of approximately equal size, each will need to mobilise about $15-20 million over 3-5 years to renew its large bus fleet, and a further $5-8 million to renew its small bus fleet.

It is unlikely that the operators can mobilise this level of finance, especially as commercial lenders do not give 100% loans for assets and typically require the borrower to put up 20-30% of the asset price as matching funds. This would require the operating companies to have $4-7 million in cash upfront to drawn down loans to meet the required investment funds.

Backed by the Area Franchises, creditworthy operators are likely to be able to get loans for asset renewal. However, the comments above indicate that for at least the early years of the Area Franchises, the bus operating companies will only be able to finance part of their fleet through borrowings.

9.1.2. Special Credit Line is established for Loans to Operators

A combination of donors and/or agencies could make a special line of credit available to the Bus Operating Companies. This could be available to the companies which are granted the Area Franchises, as they would have a more secure income source and would be protected from competition.

The special credit line could have favourable conditions such as:

- Lower interest rates, e.g. with low or zero risk premium
- Longer term of loan, better aligned to economic life of the vehicle
- Accept the asset as sufficient collateral, no requirement for the company or its directors to give additional collateral or guarantees
- Loans of up to 100% of the asset price (vehicle plus initial supply of spare parts)
- Easy repayments in first year of Area Franchise as the network/service changes and organisational efficiencies are being established

Such a credit line would still require credible business models and financial plans, but the thresholds could be lower and more accepting of new ventures.

9.1.3. Inward Investment to the Bus Operating Companies

Investors could bring cash or vehicles in return for an equity stake in the company.

This would have the advantage of reducing the amount of upfront cash that the company would require to obtain vehicles – e.g. cash equity could provide the 20-30% upfront contribution to the asset price for commercial loans.

The nature of the investor and the expected basis of participation can include:

- 'Silent' investor who provide equity in return for an agreed repayment schedule (in effect a direct loan), and whose shareholding and participation in the company is expected to terminate within a number of years
- Investor who hopes to sell his shareholding at a profit at a later stage (either to other shareholders or to 3rd parties) as the company becomes established and profitable
- Investor who expects to take an active role to protect his investment, and probably seeks a role in the Board
- Investor who joins the company as a partner, and typically might bring additional skills and management capacity to the company to assist in the start-up and business development

The existing companies are likely to wary of inward investors, especially those who are not traditional operators, as they will fear dilution of their interest and even being taken over. Even though most companies in other sectors avail of inward investment to develop and expand, it remains to be seen whether it will be accepted in the bus sector in Palestine.

9.1.4. Leasing

Leasing is a different concept, in that the Bus Operating Company is not the legal owner of the vehicle throughout the lease period, and might never own the asset. Three forms of leasing are identified:

Financial Lease:

- A financial institution leases money to operators against a montly/annual fee
- At maturity, the operator give back the initial investment or the asset
- The operator never owns the asset, but has the use of it
- This form of financing is used in many parts of MENA, but has not been used for assets such as large buses

Lease-Purchase ('Hire-Purchase'):

- Buses are made available to the operators against a monthly/annual fee
- The operator can give back the bus if he does not need it or can't afford it (there may be 'break' penalty for early termination)
- At maturity, the operator has the option to purchase the vehicle outright at a nominal price

Bus leasing company:

- A special purpose company buys the buses
- The operator enters a long-term lease contract, with penalties for early termination
- Major maintenance and technical support is made available
- The operator may have option to buy the bus at the end of the lease period, otherwise it returns to the bus leasing company

Bus leasing has many advantages, but it represents a major change to the Palestinian bus operators, who are used to owning their buses and see them as a basic asset of their company. The traditional operators are unlikely to accept this option and will probably opt for loans even they are more expensive over the lifecycle.

By contrast, the new consolidated companies are more likely to take an objective view of the business case, knowing that if this strengthens their company they will be in a better position to take loans and purchase in 5-10 years when the leases expire.

9.2. Bus Leasing Company

Fleet renewal is a priority, but is currently beyond both the financial and technical capacity of the operators. One option would be to establish a Bus Leasing Company for the West Bank, which would provide vehicles on long-lease to the consolidated companies which have secured area franchises. This would allow probably two models of bus (one large, one medium-size) for all of the West Bank, leading to elimination of the current fragmented situation, and hence to economies of purchase and spare parts, harmonisation of maintenance, and the ability to transfer know-how to the operators. The Bus Leasing Company would focus on the large buses, as some operators would have capacity to purchase or locally lease small- and medium-sized buses.

9.2.1. Concept of a Bus Leasing Company

A Bus Leasing Company would probably be a special purpose entity, with the primary purpose of supplying vehicles on long-lease and carrying out major maintenance works at its own facilities. A bus leasing company could operate along the following lines:

- The Bus Leasing Company would acquire the required fleet of vehicles, based on appropriate specifications for the operating territory and expected mix of vehicle sizes
- Vehicles would be made available to operating companies awarded Area Franchises in West Bank (and later in Gaza), with the operating companies free to choose how many of their own vehicles they will use and how many to lease. It is expected that the companies would lease most or all of their vehicles if the terms are reasonable.
- Operating companies would sign a lease agreement for the agreed number of vehicles for the duration of the Area Concession, agreeing to pay a monthly leasing and maintenance charge, and accepting responsibility for the vehicle condition
- The Bus Leasing Company would provide the agreed number of vehicles in proper condition
- The Bus Leasing Company would carry out all periodic inspections and maintenance and, supply spare parts (all at pre-agreed prices) and would also carry out any unplanned repairs and overhauls.
- The operating company would carry out all front-line maintenance as well as fuelling, washing, overnight parking etc. The Bus Leasing Company would train the operating company maintenance staff and provide the necessary manuals and spare parts.
- At the end of the Concession period, the bus would be independently inspected according to an agreed procedure, and the operating company would be liable for any excessive degradation of the value of the vehicle.
- Two main maintenance facilities would be established in North and South of the West Bank, probably at Nablus and Hebron (and later in Gaza). These would carry out the primary maintenance, have diagnostic and specialist equipment, and store the needed parts.
- Optionally, the Bus Leasing Company could also establish local maintenance facilities elsewhere in West Bank and Gaza, or enter agreements with local car/truck dealers, to provide front-line maintenance locally.

A basic principle of the fair working of such an agreement is that the maintenance is done at the regular planned intervals and any issues of concern are raised as they occur. This allows corrective action to be taken at an early stage – often it just requires a little retraining of the drivers who have not realised that their driving style damages parts, or of the frontline maintenance staff to recognise early warning signs – and avoids major disagreements at the end of the lease period.

9.2.2. Scale of Financing

The principal determinants of the scale of investment finance are the number of buses acquired, and the unit cost of the buses. Initial estimates are that about 400 large buses (12 metre urban bus) are required for services in West Bank. While most of these need to be replaced urgently, the foreseen timescale is to establish the capacity over a period of 3 years. The price of a standard bus varies significantly in the range from about $70,000 to over $200,000, with cheaper buses usually having shorter working lives and increasing maintenance input requirements in the later years. The policy on import duties and VAT can also be a major factor.

For a Bus Leasing Company as described above with maintenance commitment, it would be essential to acquire buses that did have a reliable and affordable maintenance cost profile. For working purposes, a value of $150,000 per vehicle is used, which would acquire a vehicle of reasonable quality and durability, the latter being important given the current road conditions in Palestine. Vehicles would have a design reliable working life of 12 years. Vehicle investment is estimated at $60 million, but if the business case justifies a more expensive vehicle, it could be $80 million.

The other main cost items will be the establishment and equipping of two maintenance facilities, local maintenance facilities, about 2 years supply of spare parts, organisation set-up, training of Bus Leasing Company specialist maintenance staff and operating company local maintenance staff, supporting IT systems, and initial working capital. This is initially estimated at $20 million.

Total financing requirement is estimated at $80-100 million.

9.2.3. Revenue Streams

The revenue stream will almost entirely consist of the leasing charges and maintenance charges paid by the operating companies to the Bus Leasing Company. In practice, the planned maintenance would be included in the leasing charge.

Leasing charges would be set using one of four strategies:

1) Normal Charge: A normal charge would be calculated based on recovery of the asset investment over a 10-year leasing life, cost of the planned maintenance cycles, allocation of overheads, and a reasonable profit.

2) Normal Charge with risk premium: A risk premium would be calculated to reflect the primary risks foreseen for the West Bank, including risk of hostile damage to the vehicles or facilities; risk of increased closures and mobility restrictions leading to loss of revenue and inability of operators to keep up leasing charges; risk of theft or improper disposal of vehicles; risk of operators being unable to manage the Area Franchises properly and defaulting. This risk premium would be added to the calculated normal charge.

3) Normal Charge with risk premium waived or underwritten: The risk premium could be waived or underwritten by a donor or sponsoring Government. For example, a Government could undertake to step- in for payments if there was a deterioration of the political or mobility situation. Alternatively, or in conjunction, entities such as the World Bank's MIGA or OPIC may be able to provide risk guarantees. This would share or completely relieve the Bus Leasing Company of one or more specific categories of risk, and allow normal charges to be applied.

4) Discounted Charge: A discounted charge could be offered if part of it is underwritten by third parties. Possible options include:

- The PNA could either forego the duties and taxes on the vehicles or, of this is not feasible under the financial rules, could give an equivalent rebate to either the Bus Leasing Company or to the operating companies who lease from the Bus Leasing Company
- A donor or sponsoring Government could underwrite a discount for the first 2-3 years of the lease period to give the operating companies time to restructure and gain operating efficiencies and improved cashflow and profitability

- On a similar basis, the Bus Leasing Company could structure the charges so that the first periods are at lower charges, then escalating to a revised Normal Charge so that more of the return is received in the later stages.

These options need to be considered by both the investors and the PNA.

9.2.4. Necessary Legal and Regulatory Requisites

The development of a Bus Leasing Company scheme involves a significant investment, and needs reasonable assurances of stability and opportunity to recover the investment with reasonable profit. The following conditions would be required:

- Establishment of an agreement with PNA to be recognised as the official Bus Leasing Company, subject to a set of mutually agreeable performance criteria
- Commitment from the PNA that no competing bus leasing company would be allowed to be established for a minimum period of 7 years (i.e. sufficient to assure a second lease period, if the lease period is 5 year), subject to the Bus Leasing Company fulfilling its obligations
- Commitment from the PNA that the Area Franchise companies must either be the owner of vehicles they operate, or must lease them from the Bus Leasing Company
- Commitment from the PNA to the Area Franchise structure, and that the Area Franchises would be protected from extractive competition
- Commitment from the PNA to assist the Bus Leasing Company with land acquisition and resolution of tax and legal matters, where relevant

In addition, the PNA would commit to identifying potential tax reliefs and other incentives which would enhance the business model and reduce costs to both the investors and the Operators.

9.2.5. Possible Investor Structure

The Bus Leasing Company would be very suitable for PPP. The potential investors would be:

- Bus supplier, who would provide vehicles, parts, maintenance equipment, training and know-how, in return for significant shareholding
- Investors who can provide risk assurance such as MIGA (Multilateral International Guarantee Agency), giving confidence to other investors
- Financing company (e.g. PIF) or investors who would provide cash investment to part-pay the bus supplier, in return for shareholding

The bus supplier would receive part of the financial equity to allow immediate recovery of production costs, with the balance of the normal sales price remaining in the company as equity. This commits the bus supplier to providing both a good product and good lifecycle support in order to achieve its anticipated return on the project.

Investors recover their investment from the surpluses generated by the bus leasing charges after deduction of operating expenses.

10. Adapting the Regulatory Framework

The Regulatory Framework needs to be changed to support the new passenger transport business framework (the Area Franchises) and to enable the sector to develop and change. The main changes that will be required in the regulatory framework are:

- Designate the Passenger Transport Authority, define its governance structures, and define its functions and scope of authority
- Establish that the Passenger Transport Authority has all rights on road passenger transport services, and that any such services are only operated under permit from the authority
- Enable the designated Passenger Transport Authority to:
    - enter into contracts for Area Franchises and other service agreements, to manage them, and terminate them as required
    - set vehicle, service and performance standards and require that operators on authorised routes comply with them
    - allocate subsidies to Area Franchises and any other contracted routes
    - organise and distribute funds for reimbursement of free and/or reduced rate travel
    - co-ordinate services across and within Area Franchises
    - co-ordinate and/or require participation in cross-Area and integrated ticketing, passenger information and other customer support services
    - initiate supporting projects such as traffic management measures, bus priority measures, terminals and interchanges facilities etc.
- Make provision in law for Area Franchises, allowing for:
    - award of area concession
    - provision of exclusive service concessions for a designated area
    - restriction on existing operators and refusal of requests from other operators
    - termination of all existing permits in an area
    - any flexibility required in route operating permits
- Make provision for services to Gaza, Israel and neighbouring countries, in the event that the restrictions on such services are removed
- Define relationships with other key stakeholders such as Municipalities and Governorates
- Strengthen enforcement powers, where required

This will require a comprehensive review of the relevant legislation and regulations, examining the extent to which they currently permit, limit, prohibit, or simply do not make provision for the new passenger transport framework.

The recommended actions are:

- Take a formal policy decision to implement Area Franchises
- Carry out a comprehensive review of the current legislation and regulations, as well as the range of permits currently in use and issued under various mandates
- Specify the functional requirements for the new regulatory framework, taking into account the foreseen Area Franchises and international practice
- Develop the new regulatory framework, and any necessary laws and regulations. Ensure that any new laws enable the Minister to make regulations and avoid details in the primary Law
- Design Area Franchise specifications and agreements in compliance with the new regulations

11. Restructuring the Public Transport Department

A new capacity is required at the Passenger Transport Authority to support the new regulatory framework. This will require either:

a) Maintaining the Passenger Transport Authority and regulatory role within the Ministry of Transport, and hence restructuring the Public Transport Department; or

b) Establishing a new authority or agency which takes on one or both of the roles of Passenger Transport Authority and/or Regulator.

It is assumed that both roles remain within the Ministry of Transport and that the Public Transport Department is restructured and enabled accordingly. It the decision is taken to allocate the roles to another agency or unit, than the functions and capacity described here are equally relevant.

The format of the Passenger Transport business is now facing major change:

- Area Franchises or other consolidated operating permits will be granted
- Consolidated companies or unions will be formed, which will have new capacities and needs
- Reinvestment will be made in the fleet, requiring a stable framework and support

In response to these changes, the Public Transport Department needs to adapt to:

- provide effective regulatory capacity
- acquire technical capacity and knowledge to manage and support the sector

Analysis of a range of international good practice cases shows that the role of the passenger transport Regulator includes the following main functions:

- Implement transport policy and strategy
- Balance the interests of the customer and the suppliers
- Manage competing demands for operating rights
- Allocate market access and rights
- Set conditions for participation by operators
- Define performance and quality standards
- Monitor performance and behaviour
- Takes corrective action and imposes sanctions as required
- Prevents excessive profit-taking

Passenger Transport Authorities typically take the following roles:

- Regulate the passenger transport sector
- Establish the design parameters for the service, and may design the network itself
- Procure the passenger transport services, under permit or contract
- Arrange support finance for services and for free/reduced rate travel for target groups
- Provide the framework for, and may lead, the development of customer-facing services such as ticketing, passenger information, support facilities, and integration of these services

11.1. Functions of the Passenger Transport Department

Based on international good practice and the emerging requirements in Palestine, the sector-specific Functions of the Passenger Transport Department would be:

- Set the Policy for the passenger transport supply
- Develop, monitor and manage the Area Franchises and their associated Contracts
- Establish and manage the administrative and legal processes for permit issuing
- Define and monitor performance and quality standards of the services and operators
- Assess the effectiveness of supply through research, and intervene where required to establish new routes or strengthen existing ones
- Set tariffs and financial policy, based on good knowledge of the industry business and cost structure
- Arrange reimbursement of free and reduced-rate travel
- Harmonise (and develop where necessary) integrated customer-facing services
- Enforce regulations, control against unauthorised operations
- Work with Municipalities to:
    - improve operating conditions for passenger transport services
    - develop traffic management and bus priority schemes in the urban areas
    - improve terminals, passenger facilities and parking
    - upgrade bus stops and waiting places
- Carry out research on the passenger transport sector
- Acquire and transfer international know-how and provide technical guidance to the sector

These would be in addition to the normal administrative functions of any Department.

11.2. Developing the Capacity of the Public Transport Department

Capacity development of the Public Transport Department requires the following key actions:

- Develop an effective organisational structure, which will require:
    - A well defined mission
    - The Department is empowered with sufficient authority
    - Adequate and stable financial resources
    - Well defined and developed institutional and working relationships with other Departments within the Ministry and other relevant agencies
- Source and retain suitably qualified, professional, well trained, committed core staff:
    - Head of unit with strong policy and administration capacity
    - Transportation planning and demand assessment expertise
    - Passenger transport operations, management and systems expertise
    - Transport economics expertise
    - Contract management and monitoring capacity
- Establish data collection and analysis systems and capacity
- Establish the funding mechanisms for the personnel and activities of the Department

12. Managing the Shared Taxi Sector

The Shared Taxi sector has a valid role to play, and they are legally and properly authorised to carry out their work. A large number of people uses these services every day and depend on them for their mobility. At the same time, the bus sector states that shared-taxis cause serious damage to their revenue stream, and wish to see them significantly reduced. The challenge is to find a reasonable balance that, at the very least, does not reduce mobility for the inhabitants of West Bank and Gaza.

Without doubt, there is oversupply in the shared-taxi sector. This dates to an earlier period when large numbers of permits were issued without proper consideration of the appropriate size of the sector. The oversupply of permits damages both the bus sector and the incomes of the individual shared-taxis themselves, so that shared-taxis are often idle while waiting their turn for work.

The problem is compounded by the large number of authorised taxis for individual hire, and the presence of illegal taxi operations. This takes business from the shared-taxi sector which, in turn, is motivated to extract from the bus sector.

The number of shared-taxis needs to be reduced significantly to an appropriate level, which then works in a well-defined market sector. The following measures are recommended:

- Enforce strongly against illegal operations by shared-taxis
- Enforce strongly against violation of permits, such as off-route operations or oversupply of units on bus routes
- Systematically check (e.g. at renewal) whether:
  - the vehicle and the driver using the permit are those actually authorised to do so
  - tax requirements are being complied with
- Raise the mandatory standards for vehicle conditions and roadworthiness, and enforce these in annual vehicle inspections
- Require all shared-taxi drivers to attend specific training courses for refreshing driver skill and for customer care
- Systematic field inspections of vehicle and driver permits and fitness to operate
- Cease issue of new permits for a period of 3 years
- Increase the annual fee for permits, as the declining number of permits will increase the earnings for those who remain in the business
- Implement strong control against illegal operations by taxis, so that the authorised business of the shared-taxis is properly protected

These measures are expected to displace illegal operators and those who are unwilling to spend money on the basic requirements of vehicle quality, maintenance, and driver training.

It is recommended to avoid discussion of buying out shared-taxi licences until the above measures have been established.

13. Action Plan

The Ministry of Transport has adopted following Action Plan in pursuit of the reform and development goals and objectives in Passenger Transport.

	Actions	Who	Launched by
A	***Deepening the Legal Union (LU) Concept***		
A1	Perform regulatory framework due diligence	MoT	November 2008
A2	Initiate discussion among operators about operation arrangements	Operators, MoT	November 2008
A3	Prepare TORs for LU business and operational plans	WB	November 2008
A4	Prepare TORs for by-laws and LU internal structure study	WB	November 2008
A5	Discuss with MoT detailed/specific requirements for route and permit flexibility (Unions, MoT)	MoT, Operators	January 2009
A6	Prepare LU business and operational plans	MoT, Operators	February 2009
A7	Prepare by-laws and LU internal structures	MoT, Operators	February 2009
A8	Launch Legal Unions	MoT, Unions	February 2009
B	***Engaging institutional reform***		
B1	Draft new Public Transport Committee missions, outputs and related timeline	MoT, Operators	November 2008
B2	Issue concept note on MoT public transport dpt restructuring	WB	November 2008
B3	Completion of Design (functions, structure, skills, means) the MoT Public Transport Dept.	MoT	June 2009
B4	Preliminary study on area franchises options	MoT	September 2009
B5	Develop a strategy for shared-taxis	MoT	September 2009
B6	Policy decision on whether to proceed on Area Franchise	MoT	September 2009
B7	Revised legal and regulatory framework for Franchises in place	MoT	December 2009
B8	Completed implementation of MoT Public Transport Dept. restructuring (incl. capacity building)	MoT	September 2010
C	***Elaborating on Financial Issues***		
C1	Initiate discussions with potential investors/donors	WB, MoT	November 2008
C2	Working note: bus fleet renewal options comparator	WB	December 2008
C3	Prepare TORs for Franchisees business plans	MoT	March 2009
C4	Prepare business plan for Franchisees	MoT	September 2009

C5	Develop a strategy for reimbursement of free and reduced fare travel	MoT	September 2009
C6	Make decision on way to finance bus fleet renewal (New / second hand buses; preferred mechanism to finance them)	MoT	September 2009
C7	Completion of financial arrangements	MoT	December 2009
D	***Implementation actions for the area franchises***		
D1	Conclude the agreement for the Bus Leasing Company (or loan/funding channel)	MoT	December 2009
D2	Network design of the area franchise	MoT, Franchisees	June 2010
D3	Procure and sign contracts for Area Franchise	MoT	March 2010
D4	Franchisees organize staff, facilities, systems	Franchisees	October 2010
D5	Establish maintenance facilities and training	MoT, TBD	September 2010
D6	Reimbursement for free and reduced fare travel	MoT	December 2010
D7	Upgrade terminals, parking and passenger facilities	MoT, Cities	October 2010
D8	Traffic management measures in city centers	MoT, Cities	October 2010
D9	Launch Area Franchise	MoT	January 2011
D10	Order buses, delivery and commissioning	MoT, TBD	From Q1/2010
D11	Harmonized traveler information for West Bank	MoT, Franchisees	Beyond 2010
D12	Harmonized ticketing and fares for West Bank	MoT, Franchisees	Beyond 2010
E	**Next Steps in Passenger Transport Development**		
E1	Initiate Public Transport and Gender issues technical assistance	MOT & WB	January 2009
E2	Initiate energy efficiency for public transport technical assistance	MOT & WB	January 2009

14. Annexes

This report is supported by the following Annexes:

1) Discussion Note on Area Franchises

2) Discussion Note on Bus Leasing Company

3) Discussion Note on the Regulatory Framework and Passenger Transport Department

4) Draft PCN on Energy Efficiency and Alternative Fuels

5) Draft PCN on Gender Issues in Transport

6) Study of the Passenger Transport sector in West Bank and Gaza, with detailed analysis of Hebron and Nablus (prepared by Dr. Khaled al Sahili of an-Najah University, Nablus)