



NZIQS
THE CONSTRUCTION COST SPECIALISTS

NEW ZEALAND
INSTITUTE
OF
QUANTITY
SURVEYORS

Enhancing NZ's construction industry:

A briefing from the
NZ Institute of Quantity Surveyors



The construction cost specialists

The New Zealand Institute of Quantity Surveyors wants to raise two construction industry-related issues with Government:

- The issue of risk transfer in construction industry contracts
- The need to prioritise whole-of-life operating costs when designing construction projects.

Construction Industry Risk Transfer: A major issue that must be addressed before it creates further industry issues

The situation with Fletcher Construction Building & Interiors highlights a key issue surrounding construction industry contracts – that of risk transfer.

Risk transfer has become an increasingly significant issue over the last two to three years and the situation has now reached a point where steps must be taken to address it, starting with Government as a major purchaser of construction industry services.

Risk transfer away from the client and on to the contractor and consultants has reached inequitable levels and puts significant and totally unnecessary pressure on the contracting parties.

At best it means construction projects are significantly more expensive than they need to be. At worst it can lead to situations like those that now affect Fletchers.

While Government is not the only client to impose inequitable risk transfer provisions, it is a major contributor to this problem.

Construction industry contracting models, especially those favoured by Government agencies, are now extremely sophisticated and designed to emphasise and maximise risk transfer on to the contractor.

For many years standard contracts such as NZS 3910 were the “go to” agreement and provided for equitable conditions with fair and balanced risk allocation. The recent trend is to amend these standard provisions with “special conditions” that supersede all of the risk provisions and in some cases seek to take away the contractor’s ability to deflect

any risk whatsoever, even that which the contractor has no control over.

This is an issue for three reasons:

- The New Zealand contracting industry is relatively unsophisticated by comparison and contractors do not always fully understand the risks they are assuming under the contract.
- There is a lack of capacity in the market – in addition to not always having the expertise to fully assess all the various risk factors, contractors often don’t have the time.
- This combination can lead to the third factor – elements of the industry still adopt a ‘she’ll be right’ attitude.

In some instances, Government contracts seek to push all risk on to the contracting party, making them liable even for contingencies and risks outside their control.

One particular Ministry is particularly conscious of risk transfer. When working for that Ministry, the contractor must agree to build to the design provided by the Ministry, but is still liable, for example, if the building is not weather-tight – irrespective of the actual design being at fault.

Another recent Government agency construction contract contained nearly 300 pages of amendments to the standard form (which is only 131 pages long in total).

It is also more and more common for ‘ground risk’ to be included in the transfer provisions despite the fact this component of the job is totally outside of the building contractor’s control.

Additionally, many contracts are written in such a way that contractors have little ability to deflect risk once the work is in progress, even if they become aware of problems caused by factors outside of their control.

While one of the problems associated with inequitable risk transfer is inflationary costs, the other problem is the exact opposite. Contractors cannot, and are not, pricing work appropriately because the price of doing so would be prohibitive. So, contractors take on work - and risk - that can cause them major financial losses if a risk - unforeseen or not - actually materialises.

They are also reluctant to push back on draconian risk transfer terms for fear of being excluded from future procurement opportunities, including those offered by Government agencies.

As a result, the industry accepts billions of dollars of contract risk annually for an average industry return of just two percent EBIT.

The losses associated with risk transfer are one of the causes of the Fletchers situation, and, as a result there is now only limited NZ-based, large scale construction capacity domestically.

Other views

The Construction Strategy Group and the Construction Industry Council have similar concerns. In a joint document produced in October last year for the Labour-led Government, the two organisations said "The construction industry needs to discuss with the Government how risk is allocated, to whom and why. Currently risk and who should take it is inadequately discussed at the start of the procurement process and therefore many contracts end up with a totally unbalanced allocation of risk. This acts as a powerful brake to innovative development."

A 2016 report by PwC *Valuing Construction in the NZ Economy* made similar comments. That report stated "... there is a clear need for government procurement processes to improve. Greater uptake of standard contracts and the potential for MBIE's procurement guidelines to become mandatory during government procurement, unless there are strong reasons not to use these, were touted as areas which would provide an immediate impact for the sector while having minimal impact on the government."

Best practice contractual models

The Institute is urging Government to lead by example when tendering construction projects. Government agencies must either accept more risk or be prepared to pay the full and reasonable price for risk transfer. There must be a more equitable and realistic balance.

In turn, industry must lift its game and become more professional and sophisticated when it comes to accepting risk and entering into contracts. Industry must be prepared to price risk appropriately or decline projects where the risk is deemed to be unacceptable.

It should be noted that construction risk can be managed intelligently with a collaborative approach and the right contract provisions.

There are many examples of best practice contracting models both in New Zealand and overseas.

We also stress that risk should be borne by the party best equipped to deal with it. In the past schedules of quantities were used extensively to minimise risk and create a level playing field for tenderers. This kind of industry tool has been replaced with either cut throat competitive tendering coupled with low margins and the risk of bankruptcy, or projects with significantly higher contract values as contractors seek to mitigate the risk that clients are not willing to take.

We urge the Government in New Zealand to acknowledge the issue, to accept its role in exacerbating the problem and to work collaboratively with industry to mitigate it.

Low cost design and construction

The Institute wants to see more focus on whole-of-life costs when commissioning construction projects.

The ongoing operating costs of a facility dwarf the costs of design and construction but are often not considered or prioritised as they should be.

Understanding these costs and addressing them at the design phase would have significant long-term financial benefits for building owners and operators, including Government.

In August 2017 the previous Infrastructure Minister Steven Joyce told a major industry conference that "...whole-of-life as opposed to cheapest price wins has become the mantra". As a body of cost professionals, we cannot agree with Mr Joyce's overly-optimistic statement. The reality from our viewpoint is that very few clients are embracing the whole-of-life approach.

The message to builders coming from a large proportion of government building contracts still seems to be "sustainable practices and good building performance are nice-to-haves, but not a requirement".

NZIQS is committed to informing and educating our members on the benefits and costs associated with sustainable building. Recent developments overseas mean the costs of achieving better building performance are coming down. We have invited Rob Bernhardt from Passive House Canada to be the keynote speaker at our national conference in June this year. He will be updating us specifically on the latest developments in this area.

In future, if new public buildings in New Zealand are to be more innovative and efficient in terms of long term cost effectiveness, then all parties to a building contract need to be better informed. NZIQS is willing to assist with keeping central and local government decision makers up to date with international trends.

About the New Zealand Institute of Quantity Surveyors

NZIQS is the body that represents professional quantity surveyors in New Zealand and, as such, we are well placed to present a balanced and informed viewpoint across multiple aspects of the commercial and public buildings sector.

NZIQS offer a professional registration scheme to members who meet certain qualifying criteria and who undertake a rigorous and ongoing programme of continuing professional development.

Our CPD scheme is accredited by the International Cost Engineering Council (ICEC) and endorsed by the member institutes of the Pacific Association of Quantity Surveyors (PAQS).

Quantity surveyors are the construction cost professionals who measure and estimate the cost of resources for construction projects. They price the cost of a construction project and are often responsible for ensuring budgets contracts terms are met.

Membership of NZIQS is split approximately 50/50 between consultants and contractors.