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The Risk of Inflation under the Public Works Contracts

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Agenda

- ☐ What has been the impact of price volatility on projects over the last 12 months?
- ☐ Has the OGP Inflation Cooperation Framework helped? Is it being used?
- ☐ What are the benefits of the Jan 2022 versions of the Public Works Contract?
- ☐ What practical solutions are parties applying to minimise the impact of inflation?
- ☐ What further steps are necessary to ensure the viability of construction projects?

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What has been the impact of price volatility on projects over the last 12 months?

What level of material price inflation has the industry experienced in the past 12 months?

Wholesale prices for construction products increased by 16.2% over 12 months

Notable annual increases in construction products as shown in Table 3 include:

Structural Steel Fabricated Metal: 57.1%

Plaster: 36.2%Cement: 29.2%

Ready Mixed Mortar and Concrete: 29.2%

Plumbing Materials incl. Sanitary Ware: 27.9%

PVC Pipes and Fittings: 26.3%

Source: CSO Wholesale Price Index December 2022, published 20 January 2023

I'm no economist but.....

- The annual rate of construction inflation over the first half of 2022 was 14%.
- The Building and Construction index which combines Materials and Wages, rose by 9.9% in 2022 but showed no change in December 2022.
- Rate of material price inflation at much lower growth rates since Q3 2022.
- Some material prices appear to be stabilising.



What are the reasons for cost inflation?

- Labour and material shortages brought on by Covid 19 and the war in Ukraine.
- Lack of availability of skilled personnel.
- Energy inflation prices of oil and gas have risen significantly.
- Tightening PI insurance market

What is the impact?

Projects are being postponed, retendered or delayed.



Has the OGP Inflation Cooperation Framework helped?

Why was it needed?

- No entitlement to EOT in PWC's for supply chain issues
- Limited potential to recover costs associated with inflation by applying PV1/PV2 under PWC's.

What is the purpose of the Framework?

- To facilitate a proportionate approach to mitigate
 - Risk of delay due to supply chain issues
 - Cost increase due to inflation
- To facilitate burden sharing.
- To mitigate risk of increase in claims being referred to adjudication or conciliation.



What is the approach?

- Voluntary
- Sits outside the Contract.
- Talks held on a "without prejudice" basis to determine the extent of the impact.
- Provides for up to 70% of the uplift to be covered by the Contracting Authority
- No Additional funding is provided where will the money come from?





How is it applied?

- **Live projects** where the cert of Substantial Completion was not requested by the Contractor by 10th May 2022.
- Live Tender
 - Optional
 - Should be stated in tender documents
 - Expert procurement advice recommended
- **Future Tender** recommended for use until the PWC's are amended to address the issues.



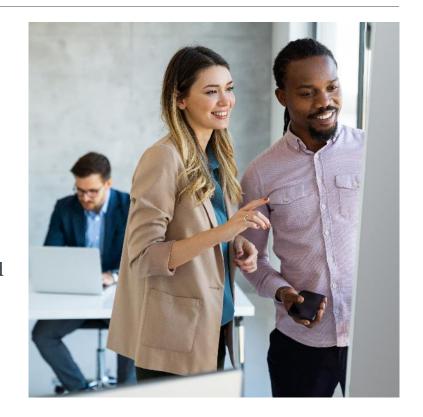
Project Categories

Category 1:

- Projects being delivered under PWC form dated
 7th January 2022.
- Material price inflation does not apply to Category 1 projects using PV1. Only energy and fuel price inflation can be considered.

Category 2

- Projects being delivered under a PWC form dated prior to 7th January 2022.
- Materials, energy and fuel costs included.



How is the relief calculated and applied?

Ex-gratia inflation amount is determined by applying wholesale price indices published by the CSO

Fuel & Energy

- Based on the movement in a specific price index applied to a portion, "The percentage", of the "Effective Value" of an interim or final cert.
- The "Effective Value" is the sum certified by the ER.

Material Inflation

- It's more complicated!
- A threshold figure is deducted from the change in the relevant index to determine the factor to be applied.

EOT

Where agreed, the ER issues a "Inflation/supply chain delay notice" and LAD's are waived if the project will be delayed beyond the Date for Substantial Completion.



Meanwhile, what happens under the Contract?

- Clause 10.3 claims are paused until the outcome of the Ex-gratia process is known.
- Any determination made for EOT/money under the Contract will be deducted from the ex-gratia EOT/Ex-gratia Inflation Amount, as applicable.

What happens if a party wants to opt out?

- The Inflation Cooperation Framework Agreement can be terminated by either party giving 2 weeks written notice of the intention to terminate.
- If notice is given to terminate the co-operation framework any clause 10.3 notice is deemed to have been submitted the day after the last exploratory co-operation meeting.



Has the Inflation Cooperation Framework helped? Are parties using it?

- The short answer is it has had mixed results.
- Voluntary status reduces its availability to contractors.
- Significant reliance on trust and relationships to make it work.
- Contracting entities relying on multiple funding streams less likely to engage because of inability to fund the framework.
- Contractors and Quantity Surveyors generally reporting good uptake by local authorities and other state bodies with a single funding stream.
- Most Contracting Entities that do engage are agreeing to the 70/30 spilt.
- Recovery by contractors reported as reasonable but issues with supply chain still remain a challenge particularly for projects tendered early 2022.
- Lack of exchequer backing seen as a major obstacle.
- Lack of contractual status is a significant concern and limits its appeal.

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The amendments to PV1 & PV2 in the Public Works Contracts

What are PV1 and PV2 all about?

- Provide a mechanism to amend the Contract Sum in the event of exceptional price increases or decreases over a protracted contract period (previously 36 months).
- Pv1 is the proven cost method, requiring the Contractor to provide evidence by way of invoices to support its claim.
- PV2 is the formula fluctuations method whereby any increases or decreases in the price of materials and fuels is calculated based on CSO indices.
- PV1 has typically been specified in the Schedule and the provisions have largely been ignored until 2021.



January 2022 amendments to the PWC's

- A reduction of the Base Date for PV1 and PV2 from 30 months to 24 months from the Tender Inflation Indexation Date.
- The Tender Inflation Indexation Date is the last day of the month in which the latest available Index is published as at the Contract Date.
- The sub-clauses in PV1 and PV2 dealing with exceptional material price increases have been amended to adjust the threshold from 50% to 15%

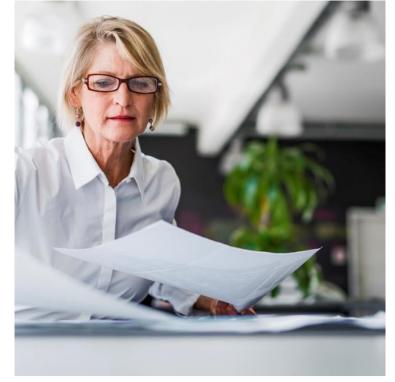
Do these amendments go far enough?

- The short answer is no framework required to fill the gaps.
- 15% inflation not sustainable in a market operating on such low margins.
- Potentially devastating implications for supply chain.



What Practical solutions are being used to limit the impact of inflation?

- Early procurement of packages to limit impact of inflation.
- Employers assisting with materials storage facilities/costs.
- Valuations allowing for higher percentage of unfixed Works items to help cover Contractor early outlay for materials and equipment.
- Designers and Employer willing to consider alternatives to avoid or minimise lead-in time delays.
- Value engineering to achieve project budget.



How can we ensure the viability of construction projects?

- Consider material lead-in time during the design process and engage with Contractors to find innovative solutions.
- Encourage and incentivise cooperation between the parties – the role of the conditions of contract.
- Support the supply chain without them, nothing gets built!
- Foster an environment where transparency is rewarded and making a profit is not considered a bad thing.
- Invest time in building relationships instead of preparing or defending claims you will reap the rewards.



Thank you for your time. Any questions?

