

A GUIDE FROM THE HOUSING FORUM

NOVEMBER 2022

Supplementary guidance
addressing the affordability crises

Better Procurement for Better Homes

How to procure in a hyperinflationary environment



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About this supplementary guide

This supplementary guidance is focused on how development in this inflationary environment can be addressed, whilst holding onto the project vision and quality.

The document looks at how to manage projects, pulling out key areas of guidance from *Better Procurement for Better Homes* and supplementing this with advice based on the current experience of industry practitioners from The Housing Forum's unique cross-industry perspective.

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Introduction

In the short time since The Housing Forum published the *Better Procurement for Better Homes*¹ guide, the procurement environment has changed dramatically. The consequences of rising costs and supply chain uncertainty are now making projects unviable and increasingly unaffordable.

For housing associations and local authorities faced with this new challenge, the option of pausing development programmes can bring other risks. They may miss funding deadlines or find the local authority administration has changed and the development been cancelled.

This supplementary guidance is focused on how development in this inflationary environment can be addressed, whilst holding onto the project vision and quality.

The document looks at how to manage projects, pulling out key areas of guidance from the original guide and supplementing this with advice based on the current experience of industry practitioners from The Housing Forum's unique cross-industry perspective.

Better Procurement for Better Homes – the basics

The Housing Forum published *Better Procurement for Better Homes* in October 2021 to address the issue of poor procurement, which has been prevalent in the sector for some time. Commissioning clients like housing associations and local authorities for whom this guide is intended, set themselves up for success or failure based on how they approach procurement.

Better Procurement for Better Homes advocates adopting a set of values and behaviours founded on collaboration between client, consultants and contractors. And at the heart of this should be the client, providing a clear project vision from the start and then subsequent monitoring and guardianship through the life of the project.

The recurring themes of *Better Procurement for Better Homes* are:

- Promoting value-based procurement
- Setting a vision and delivering the vision
- Improved project leadership / governance / guardianship
- Engagement of a single design team from start to finish
- Promoting project collaboration
- Promoting early contractor appointment and engagement
- Adopting measures to protect and lock in design quality
- Adopting measures to ensure improved quality in construction
- Ensuring residents are involved meaningfully throughout the process
- Procuring to implement the recommendations of the Hackitt Review and the Building Safety Act.

The guide also advocates the use of partnering principles or pre-contract services agreements (PCSA) and advises that an unconditional contract should not be signed until the design is fully developed and fixed, and most of the works' packages agreed.

¹ *Better Procurement for Better Homes*, published by The Housing Forum, October 2021
<https://housingforum.org.uk/reports/report-housing-supply-and-delivery/better-procurement-for-better-homes/>

Overarching changes needed to procure projects in a high inflation environment

The 40-year-high inflation rate, fuelled by rising energy costs and global supply chain difficulties, has resulted in an extremely tough landscape for procuring construction work, as contractors and their specialists become reluctant to commit to fixed prices too far in advance of work starting. This has profound implications for clients trying to plan and budget for work.

Building trust

The rationale for selecting the contractor partner should put even more emphasis on their values, ie their commitment to quality, their willingness to work in an open book environment and their ability to demonstrate a collaborative approach. Clients, contractors and consultants will be looking to those they can trust and those with whom they already have established relationships. Clients may need to adopt innovative procurement practices, and be bold in their approach to selecting partners. Historically, with open book contracts there has been mistrust, but to make it work clients need to be fully hands on and understand and trust in the process.

Closely involve the finance and procurement team

Whole-team decision making is another key area that needs strengthening to reach the right conclusion for any project that is likely to experience financial pressure. It is essential to have the project sponsor round the table whose role it is to see the project is meeting its aspirations and quality objectives. Also needed are those that deal with the procurement process and those that hold the financial strings for the project. The organisation's budget holders need to be alerted by project members as soon as inflation looks to be adding cost pressures that threaten to breach contingencies. Some clients will opt to put aside undisclosed contingencies for this very purpose.

Procurement processes need to be flexible and not present an impossible straitjacket that is more than likely to end in failure. The key decision makers need to be able to make decisions quickly based on good information. Critically the whole team needs their finger on the pulse of what is happening in the market.

Apportioning risk

In the current environment, contractors are more likely to reject taking on even a small amount of cost risk because tender pricing across most trades is fluid and unstable. Risks need to be managed equitably, acknowledging that some sort of price fluctuation will have to be accommodated over long contracts. Any fluctuation provisions should enable pricing to move down as well as up if market prices stabilise during the term of a contract.

In the current environment we are still seeing clients and their legal advisers trying to offload unfair risks to contractors through unreasonable or onerous amendments to industry standard contract conditions. We believe clients are already finding it increasingly hard to get contractors to take on the work on this basis and a more balanced approach could help speed the process of project negotiation and delivery, and is reflective of the partnering principles recommended in *Better Procurement for Better Homes*.

Early engagement

Engaging with the contractor's supply chain early – another cornerstone of the philosophy set out in *Better Procurement for Better Homes* – becomes even more important if we are to understand the true cost of a project in an unstable market. Subcontract tenders currently have a limited window with material costs fluctuating week on week. An appointment strategy that is quicker on decision making will be vital as will an open book approach.

Flexible contracting

Finally, there needs to be a contractual framework that fits around these changed circumstances, with an emphasis on more flexible arrangements and how pre-contract agreements can be managed and that can start to lock in cost early, where possible. Single-stage, fixed-price design and build contracting in the current hyperinflationary market becomes even less workable. Clients need to recognise this and instruct their consultants to look at more innovative solutions to keep housing delivery happening.

Our solution is what we see as a three-stage process, which is set out on page 6.

Navigating the project stages – in more detail

Holding onto the project vision

A statement of vision or intent is the foundation of good procurement and provides the opportunity for the client to capture all that is important about the project in a high-level way as a reference throughout its conception, delivery and management.

As we explain in *Better Procurement for Better Homes*, projects can start with the best intentions for quality and collaboration but lose direction and revert to inadequate practices, characterised by poor design and build procurement. Having a project vision provides a guiding star. But with increased pressure on costs, holding on to this vision can become even harder and it is essential to take steps – that could be for both new and existing projects – which continue to keep the initial vision at the centre. Client mentorship, that is having a senior representative from the client taking a hands-on role, is vital to speed up decision making.

We suggest all the parties need to come together to establish where the red lines are on design and quality and agree what they might be able to compromise on. Value management at the outset is crucial to successfully navigating this.

It's also essential for all parties to the project to understand cost, programme and quality parameters, how viability is determined, and what are the funding parameters.

Establishing the right team for good decision making

Working with people and organisations you trust (not just clients and contractors but, consultants too) is good practice.

Decision makers need to be on-board and engaged in the project and team continuity encouraged. Again, it is important to have the right individuals on the team, but this is particularly difficult in a buoyant market where good people are in demand. The emphasis must be on bringing individuals through who are properly trained and given the right experience and opportunities. Those who do manage to secure the right people would be wise to tie in a 'Number 2' as a mentee.

An important factor in procuring quality on site is continuity of the design team and specialist supply chain through design stages and then during construction, maintaining a golden thread of embedded design information from project inception to completion. As we discussed in the original guide, too often a design team is swapped between planning and detailed design / construction, or a specialist supplier is changed during the design process. When teams are restructured, there is a loss of project knowledge which takes time to build up and is sometimes never recovered.

Designing with value in mind

Designing with value in mind can help keep down costs without compromising on design or quality. This means keeping things simple by minimising and standardising the number of different components. For example, choosing one window design rather than several different designs. Stacking dwelling types and/or bathrooms so the building's structure and services are efficient is another example of designing with value in mind.

It's also worth noting that clients will have to take a greater responsibility for design from inception and through to the appointment of contractor and beyond. The current assumption that the contractor will bear the risk throughout, even for inaccuracies in the designs commissioned by the client, is no longer workable. It is also necessary to understand who retains design responsibility and liability.

Where consultants are typically employed by (and therefore answerable to) contractors for the delivery stages of design and build projects, they have no contractual power. Yet they are also increasingly expected to monitor compliance and will take on additional responsibilities under the Building Safety Act. Clients may want to consider appointing design consultants independently from contractors and use their expertise through site inspection to maintain quality in design through to construction.

Appointing the contractor / supply chain

The main principles set out in *Better Procurement for Better Homes* of appointing main contractors and the supply chain early are even more critical in a hyper inflationary market. Appointing the contractor at the earliest opportunity (potentially at the pre-planning stage) under a flexible partnering contract, or using a PCSA, is vital to manage design and risk and optimise use of modern methods of construction (MMC).

Clients can aim to reduce the time from appointment to start on site by appointing contractors from frameworks. Firms on these frameworks will have already been cleared against certain criteria – and clients can take comfort that these firms will have had to have demonstrated, amongst other things, financial probity and a good health and safety record.

As in our original guide, bringing the supply chain in early also remains a high aspiration, but this is likely to prove difficult in the current landscape, and the process of bringing on board suppliers is likely to be spread out for a much longer period.

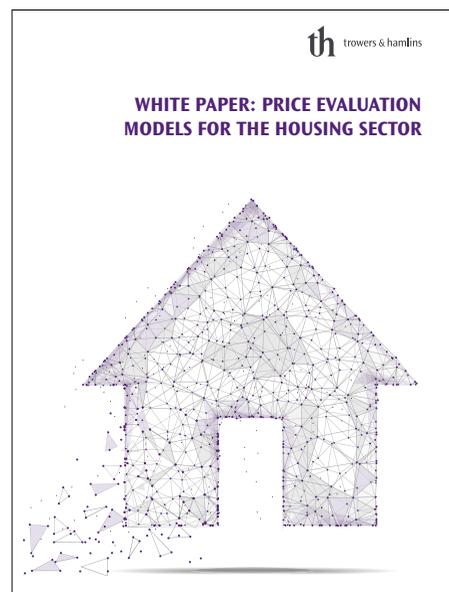
We would also suggest that clients review their approaches to price evaluation, and avoid procuring on the basis of a relative price evaluation methodology which awards the highest price scores to the lowest price tenderers.

A White Paper on price evaluation models², led by Trowers & Hamlins, sets out alternatives that clients could use, and this is referenced in the DLUHC guidance. Whilst setting appropriate quality weightings can indicate a client's preference for a high quality outcome, unless this is translated into the price evaluation methodology, it will not achieve the desired outcome. Additionally, clients should include a robust mechanism for dealing with abnormally low bids (both as an overall price, and on a more detailed review of price breakdowns).

A degree of negotiation to arrive at the final sum may be appropriate. Any perceived lack of competitiveness can be overcome using PPC2000 style 'business cases' for each key works / trade package and any elements of suspicion over costings can be overcome by the appointment of an independent quantity surveyor or employer's agent. Don't forget joint ventures between developers and contractors can work well in this aspect.

Cost certainty and risk management, as we've said, is particularly difficult at this point in time. Risk and therefore cost can be reduced by clients taking on more risk themselves, potentially appointing contractors for more work under PCSAs, and then establishing a robust cost plan together.

Understanding and recognising fluctuations in supply costs and how these can be managed and accommodated and inflation must be factored in.



² *White paper: price evaluation models for the housing sector*, Trowers & Hamlins, March 2021
<https://www.trowers.com/insights/2021/march/white-paper---price-evaluation-models-for-the-housing-sector>

A step by step guide for local authorities and housing associations to appointing a contractor

At the outset

- Make sure the scheme is viable – having initial approval will reduce the time it takes from the initial appointment to getting started on site.
- Have funding in place before the tender and selection process begins – and seek to set aside an undisclosed contingency.
- If demolition of existing buildings is part of the programme, start proceedings early to clear legal matters, eg, vacant possession, etc.

Stage 1

- Undertake an exhaustive pre-selection process, or select a suitable framework – this provides a degree of trust and a shortcut to the selection process or undertake an exhaustive pre-selection process based on quality and demonstrable / known previous experience.
- Link the project size/complexities with the appropriate contractor.
- During the pre-market engagement stage speak to a long-list of 4 to 5 firms to gauge appetite and issue formal expressions of Interest. Though ideally clients might want to speak to more, the reality of the current market may limit numbers.
- Narrow down to a list of 3 or 4 contractors to invite to tender. We are suggesting this number in the light of market conditions, but if using a framework, the rules of the framework will dictate how many can be invited to tender. If clients are using a restricted procedure the minimum number is 5; for those using competitive dialogue, and competitive procedure with negotiation the minimum is 3.
- Issue stage 1 documents and give an indication of stage 2 documents – stage 1 needs to be focused on establishing the true costs early – though inflation needs to be factored in.

• Stage 1 should focus on:

- Fixing the overheads and preliminaries
- Indicative design fees/management/coordination costs
- Establishing an indicative cost plan
- Include provision for dealing with abnormally low or high pricing
- Indicate the approach to risk sharing and incentivisation (see box right). Risk sharing is absolutely vital. Until the contract is let, prices will continue to rise. For public sector procurement, setting out how the risk will be apportioned should be included at this stage as part of the terms and conditions of the contract.
- Ask contractors for their approach to procuring the supply chain – clients and their contractor partners need to establish the same relationship with the supply chain as they do with consultants.
- Review cost against viability assessment.

Stage 2

- **Narrow down the main contractor to the final 2 to 3 contractors.**
 - Ask for more detail on their bid proposals and for a more detailed cost plan leading to fixed price
 - Request a priced risk register, particularly looking out for key aspects of the design or site conditions, to bottom out where the risk is still left in the job and indicative costs associated with that
 - Undertake a price assessment using a methodology that ensures the lowest price does not automatically get the maximum price score. Alternative methodology is set out in the Trowers & Hamblins white paper, referenced on page 5
 - Review against viability.

Stage 3

- **Select a partner.**
 - Draw up an agreement prior to signing of the contract – apportioning risk fairly between parties and balancing a fair risk and reward in the contract terms. This needs to remain as set out under stage 1 for public procurement contracts
 - Agree reporting/cost monitoring protocols
 - Review regularly against the client's viability assessment
 - Sign the contract once 70-80% of works packages are procured. (Note, this is an ideal percentage – but the reality of working in this environment, may mean that is difficult and the contractor may need to be signed with a fewer number, but with scope in the contract for inflation).

INCENTIVISATION

Incentivisation is recommended with early contractor involvement and it works well even in this market. Typically, not all design information or risks will have been bottomed out when the contract is signed.

However, it should be possible, based upon the contractor's and the cost manager's experience, to agree on the target price. Above the target price will be the 'guaranteed' or 'agreed' maximum price, which is usually arrived at taking into account cost allowances against unknowns and risks and which will typically be the contingency.

Any increase between the target price and the agreed maximum price can then be shared on agreed proportions between the parties, or indeed in incremental ratios, leading up to the agreed maximum price. Costs above the agreed maximum price are then reasonably borne by the contractor unless there is a truly exceptional and unpredictable occurrence.



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The views in this report are the views of The Housing Forum and drawn from Working Group discussions and surveys of members of The Housing Forum.

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