

# IS CHEAP REAL VALUE?

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## Abstract

After less than desirable contract delivery for many years and the premature end of the latest contract caused by unsustainable pricing on their network maintenance contract, Central Hawke's Bay District Council (CHBDC) decided to take a fresh look at how they procured this major component of their business. The contract developed needed to be flexible enough to deal with changes that would likely come about with the One Network Road Classification coming into effect; it also had to balance contractual requirements with shifting level of service delivery. GHD worked closely with CHBDC to develop the request for tender document, and a robust evaluation and negotiation process. The recommended and adopted procurement method was Quality Based with a pricing model that separated out profit and overhead payment. In a world where cheap is often considered the most desirable attribute, it was a bold move to move to 100% quality on a \$4m p.a. maintenance contract. This presentation gives insight to the reasons behind this change, the process of procuring and negotiating with the successful contractor and how, in the quality-based procurement process, CHBDC is satisfied that the competitive price received represents value for money.

## Key Words

Procurement, network maintenance, Quality based, tender evaluation

## Introduction

When procuring services for local authorities it is a challenge to demonstrate value for money whilst also providing for quality delivery. Whether it is physical works or professional services the competitive nature of the New Zealand market often results in unsustainable pricing. While the NZ Transport Agency has a clear process for dealing with unsustainable pricing, most territorial local authorities find it extremely difficult to justify to their councils why the lowest price should not be accepted.

The reasons for low or unsustainable pricing are wide and varied, ranging from simple mistakes to over-aggressive and unrealistic pricing strategies. While tenderers can be asked to confirm their price and understanding of scope; and given the opportunity to withdraw their tender, in our experience they hold fast. The result for any business that takes on a significant piece of work is typically a reduction in delivery, or resourcing that results in higher client management costs and issues, and increased scrutiny from stakeholders on the level of service of the network..

The last two maintenance contracts for CHBDC had been procured under the Quality Price Method, with the 2013 contract being awarded for approximately 30% under the Engineer's Estimate and median price. The contractor was given the opportunity to withdraw but chose not to.

A post-tender award price sensitivity analysis was conducted on this contract which was the standard 'price quality' set at 70% price and 30% quality. Using the same scores achieved for each tenderer during the evaluation and alternating the values of "Price" and "Quality" it was determined that, to obtain a different result, the price value would fall between 15% and 20% while the quality value would be between 80% and 85%. Although this would have altered the result in who was awarded the contract, the district would still face a master - slave relationship, as in not a lot of agreement on expectations, and not necessarily a collaborative value for money contract.

In an attempt to mitigate these issues GHD and CHBDC embarked on a process to consider options for procurement that mitigated risk and provided benefits over the traditional procurement approach for long term network management contracts.

### **The Impact of No Change**

Should Council decided not to change the way it procured these services the potential impacts included:

- The council ends up with another tenderer who underbids the contract work and tries to take shortcuts by not meeting the specifications or timeframes thus increasing the rate of asset deterioration and increasing the travel and safety risk to the users
- Continuing with a master - slave relationship type contract that is generally confrontational and causes extra work for both parties
- Tendering maintenance contracts on a more frequent basis which is time-consuming and adds extra cost to the District
- Adding extra work in contract management and supervision to ensure that the specifications are being met
- A contract that does not allow the flexibility to negotiate specification changes and service levels as will be required by the One Road Network Classification system

All of the above prevent Council from achieving value for money and entering into a more favourable working environment.

### **The Benefits of Change**

Central Hawke's Bay District Council wanted a procurement method that provided the following benefits:

- Encouraging and enabling a collaborative working relationship throughout the contract
- Providing the best option to align expectations of both parties during the procurement process
- Enabling mutual understanding of each party's financial and commercial opportunities and risks
- Allowing for an open book philosophy
- Supporting service level and activity level changes to meet the requirements of the One Road Network Classification System
- Supporting a flexible approach to maintenance interventions at the right time with the right solutions based on the function of the road which may change over time

- Providing the flexibility throughout the contract period to negotiate and make 'fit-for-purpose' contract adjustments
- Ensuring best value for money and whole of life decisions are made throughout the contract
- Allowing opportunities to negotiate with different suppliers in the evaluation process
- Enabling the district to control the contract expenditure during the negotiation process

## Procurement Options Considered

There are several procurement options available where the District can, to some degree, improve on the status quo and attain the benefits noted. These are shown below with advantages and disadvantages.

### Purchaser Nominated Price

This method would see the District go to market with an RFT that sets the dollars available in the budget, a schedule of work to be completed along with specifications for the work to be done. The industry then responds by developing what they feel is their best proposal to meet the District's expenditure. These are evaluated and the best proposal is awarded the contract.

Benefits	Yes	No
Encouraging and enabling a collaborative working relationship throughout the contract	✓	
Providing the best option to align expectations of both parties during the procurement process	✓	
Enabling a mutual understanding of each party's financial and commercial opportunities and risks	✓	
Allowing for an open book philosophy		X
Supporting service level and activity level changes to meet the requirements of the One Road Network Classification System		X
Supporting a flexible approach to maintenance interventions at the right time with the right solutions based on the function of the road which may change over time		X
Providing the flexibility throughout the contract period to negotiate and make fit-for-purpose contract adjustments		X
Ensuring best value for money and whole of life decisions are made throughout the contract		X
Allowing opportunities to negotiate with different suppliers in the evaluation process should negotiations fail with the best tenderer		X
Enabling the district to control the contract expenditure during the negotiation process	✓	

### Two Staged Procurement

A two stage procurement is where the district asks industry for proposals to complete the work and then evaluates the proposals creating a short list of qualified tenderers who are asked to submit prices for the work. The best of these is then awarded the contract.

<b>Benefits</b>	<b>Yes</b>	<b>No</b>
Encouraging and enabling a collaborative working relationship throughout the contract		X
Providing the best option to align expectations of both parties during the procurement process	✓	
Enabling a mutual understanding of each parties financial and commercial opportunities and risks		X
Allowing for an open book philosophy		X
Supporting service level and activity level changes to meet the requirements of the One Road Network Classification System		X
Supporting a flexible approach to maintenance interventions at the right time with the right solutions based on the function of the road which may change over time		X
Providing the flexibility throughout the contract period to negotiate and make fit for purpose contract adjustments		X
Ensuring best value for money and whole of life decision are made throughout the length of the contract		X
Allowing opportunity to negotiate with different suppliers in the evaluation process should negotiations fail with the best tenderer		X
Allow the district to control the contract expenditure during the negotiation process		X

### **Quality Based**

This procurement type is where the district puts out an RFT including the budget, a schedule of work to be completed along with specifications for the work to be done. Tenderers are requested to provide proof of their attributes as they relate to the RFT along with a price schedule. The tenders are evaluated and ranked and then the price envelope of the highest ranked tenderer is opened and the district then negotiates a contract with the highest qualified tenderer. If the District fails to negotiate a contract with the most qualified supplier then negotiations can proceed to the next highest ranked tenderer until such time as a successful tender is negotiated

<b>Benefits</b>	<b>Yes</b>	<b>No</b>
Encouraging and enabling a collaborative working relationship throughout the contract	✓	
Providing the best option to align expectations of both parties during the procurement process	✓	
Enabling a mutual understanding of each parties financial and commercial opportunities and risks	✓	
Allowing for an open book philosophy	✓	
Supporting service level and activity level changes to meet the requirements of the One Road Network Classification System	✓	
Supporting a flexible approach to maintenance interventions at the right time with the right solutions based on the function of the road which may change over time	✓	
Providing the flexibility throughout the contract period to negotiate and make fit for purpose contract adjustments	✓	
Ensuring best value for money and whole of life decision are made throughout the length of the contract	✓	
Allowing opportunity to negotiate with different suppliers in the evaluation process should negotiations fail with the best tenderer	✓	

Allow the district to control the contract expenditure during the negotiation process	✓	
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### Competitive Dialogue

This process is where the District enters into a dialogue with all qualified suppliers as to how best to meet the specifications for a specified amount of money. The District goes to market with an RFT that sets the dollars available in the budget, a schedule of work to be completed along with specifications for the work to be done. All ideas are brought to the table and unless there is a very compelling case to show that any idea is intellectual property they are shared with other tenderers

Benefits	Yes	No
Encouraging and enabling a collaborative working relationship throughout the contract	✓	
Providing the best option to align expectations of both parties during the procurement process	✓	
Enabling a mutual understanding of each parties financial and commercial opportunities and risks	✓	
Allowing for an open book philosophy	✓	
Supporting service level and activity level changes to meet the requirements of the One Road Network Classification System	✓	
Supporting a flexible approach to maintenance interventions at the right time with the right solutions based on the function of the road which may change over time	✓	
Providing the flexibility throughout the contract period to negotiate and make fit for purpose contract adjustments	✓	
Ensuring best value for money and whole of life decision are made throughout the length of the contract	✓	
Allowing opportunity to negotiate with different suppliers in the evaluation process should negotiations fail with the best tenderer	✓	
Allow the district to control the contract expenditure during the negotiation process	✓	

### Option Selection

By going through the above analysis it was clear that two of the methods would enable the district to meet all of the noted requirements. The only remaining factor that has an impact on the choice is the time it will take to accomplish the procurement.

Because the existing contract ended prematurely, the procurement timeframe was tight. It was evident that both Quality Based and Competitive Dialogue procurement processes would fit Council's needs but the Competitive Dialogue process could not be delivered under the constrained timeframe.

A report submitted to NZ Transport Agency and Council to seek approval to proceed with the Quality Based procurement method was approved.

## The Process

It was agreed that there were three aspects of the process that needed strengthening compared to previous procurement rounds:

1. Compulsory contractor briefing so that the industry understood the drivers for change and the key changes to the document
2. Appointment of a probity auditor, who attended the briefing, provided guidance on Notice to Tenderers and sat through the tenderers presentations
3. Separation of overheads and profit so as to not drive any perverse behaviour in terms of loading or unloading rates or to create issues if work types vary over time

The heavier involvement of the probity auditor was considered to be important given the 100% quality base process to provide an independent view on the process.

Four tenders were received. Under the Quality Based procurement method only the preferred tenderers price can be opened. The preferred tenderers price was higher than the Engineer's Estimate. With previous tenders being Quality Price the Engineer's Estimate was able to be built up using the previous prices and also GHD's wider knowledge from other network contracts.

The benefit of the Quality Based process is that the client has the ability to negotiate the price and scope with the preferred tenderer. Analysis of the tendered rates against the estimate as undertaken with a schedule of those which were +/- 10% of the estimate were highlighted to the preferred tenderer for them to prepare for a workshop to understand assumptions and understanding of scope when pricing.

The preferred tenderer attended the workshop with their full cost build up for all scheduled items for the negotiation team to work through and assess issues such as:

- Assumptions around number of establishments to undertake work e.g. is the water cutting of flush seal going to be ad hoc in nature or programmed as one establishment;
- Is the specification or level of service demanding inefficient programming by the contractor e.g. is the specification for mowing resulting in peaks that require steps up in the number of mowers, i.e. you either need 1 or 2 mowers, 1.5 mowers incur the same cost as 2;
- Does the flanking specification width specify what are essentially two different operations, one that could be done by routine plant and another that is completed by specialist equipment. Would it make more sense to split the schedule so the contractor does not price for the worst case scenario;
- Talking through in detail what the expectation is around reshape grading to align and agree methodology;
- Discussions around penal vs ordinary rates and allowing for this in the schedule;
- Splitting stabilisation repairs into optimal sizes for pricing efficiency;
- Simple mistakes or double dipping of plant in cost build up.

This workshop and open book approach proved to be highly productive for both parties to get a full and clear understanding around the pricing and scope. From this meeting the

contractor and GHD worked together to document the changes within the schedule and to document agreed scope. The outcome of this was a contract award which was slightly below the Engineer's estimate and allowed the contractor a sustainable contract.

## **Conclusion**

Clients and other key stakeholders are often sceptical about removing price tension from the procurement process. The reality is that for most projects there is enough historical price information to inform any negotiation as part of a Quality Based evaluation.

Allowing a supplier to make a fair profit should not be considered a bad thing. The cost of allowing unsustainable pricing, no matter the reason for it, is far greater than the saving you may get at the tender box under other procurement methods.

Is this approach required for all situations, most probably not, but it is worth consideration.

## **Acknowledgements**

We would like to acknowledge Shawn McKinley, Land Transport Manager Central Hawke's Bay. Sections of this paper are the combined work of GHD and Shawn.

## **Author Biography**

### **Tony Harrison – NZ Network Management/eSolutions Leader, GHD**

Tony has 26 years engineering experience, 13 of which focussed on management and network management. He leads GHD's NZ network management and eSolutions business. In this role Tony provides a range of services across GHD's local authority and Transport Agency Network Outcomes Contracts. This includes contract governance, procurement advice and project management. Tony also sits on the NZ Transport Agency Industry Advisory Group for the Network Outcomes Contract.

Technically Tony delivers high quality engineering projects to his clients. His experience on local authority roads and highways provides him with an excellent 'toolkit' to draw upon to enable solutions for all types of transport networks.

### **Carey Morris – Wellington Transport Manager, GHD**

Carey has 20 years engineering experience, including 10 years on roading network contracts in NZ and Australia. He manages GHD's Wellington transport team and is involved in a wide range of projects from better business cases through to capital project design and procurement.

In 2014 he relocated to Australia be the Asset Manager on the Transport & Main Roads SEQ Brisbane Metro. As an integral part of the management team for this contract, Carey was been involved in the setting up and delivery of a new model of road network asset management and maintenance contract in the South East Queensland region's complex Brisbane Metro road network., Carey has brought strong people and project management skills to this project in a challenging environment of change and ongoing management of road user demands. Carey's leadership saw him introduce a number of new people to the team and bring them up to the required level of delivery over a period of 12 months.