



COVERSHEET

Minister	Hon David Parker, Hon Jenny Salesa	Portfolio	Minister for Economic Development / Minister for Building and Construction
Title of Cabinet paper	Use of the Construction Procurement Guidelines	Date of release	17 May 2019

List of documents that have been proactively released

Date	Title	Author
26 September 2018	<i>Use of the Construction Procurement Guidelines Cabinet Paper and revised letter from Ministers</i>	<i>Office of the Minister for Economic Development, Office of the Minister for Building and Construction</i>
26 September 2018	<i>DEV-18-MIN-0219</i>	<i>Cabinet Economic Development Committee office</i>

Information redacted

NO

Please note that pages 13-14 of the Cabinet Paper document are templates for a letter for Ministers to send to the Chief Executives and Heads of relevant departments and Crown agencies. This is the revised version of the letter at Annex Two of the Cabinet Paper (pages 10-11) following Ministerial feedback.

In Confidence

Office of the Minister for Economic Development
Office of the Minister for Building and Construction
Chair, Cabinet Economic Development Committee

Use of the Construction Procurement Guidelines

Proposal

- 1 This paper seeks Cabinet agreement for relevant Ministers to write to their respective departments, agencies and boards, using the attached letter, instructing them to adhere to the Government's Construction Procurement Guidelines and consider skills development and training as part of their construction procurement projects.
- 2 The letter is an interim measure while the Government Rules of Sourcing are updated to include the Government's work programme to leverage government procurement to deliver broader outcomes.

Executive Summary

- 3 Construction industry representatives recently met with the Minister for Building and Construction, Minister for Infrastructure and Minister of Housing and Urban Development to discuss how current procurement practices are affecting the industry and what government procurement can do to help improve the situation. Some of the issues highlighted by the industry include complex procurement processes, unbalanced risk transfer in projects and thin margins.
- 4 This meeting followed the recent media reports about issues in the construction industry, such as the liquidation of Ebert Construction Ltd.
- 5 Individual government agencies are primarily responsible for undertaking government construction procurement, with Chief Executives having the main responsibility and accountability. The Ministry of Business, Innovation and Employment (the Ministry) supports good government procurement practice by providing the government policy framework for procurement. This framework includes the Government Rules of Sourcing and the Construction Procurement Guidelines.
- 6 The Government is in a position to leverage its capital investment spend to take a leadership role and set the standards for best practice. This can be immediately done by government agencies adhering more closely to the Government Construction Procurement Guidelines (the Guidelines). The Guidelines were developed in conjunction with industry and set out processes such as, consideration of whole of life costs and outcomes of projects rather than just lowest bids for tenders. Use of the Guidelines will help address some of the issues the industry is facing. The industry is supportive of this action.
- 7 The lowest cost bids model, where contracts are generally awarded based on the lowest bid, is also enabling businesses that do not upskill their workers or take on apprentices to undercut those that do, discouraging investment in workforce skills development.
- 8 We propose that ministers write to their respective departments and agencies instructing them to follow the Guidelines and to begin thinking about how they can use their construction projects to support skills development and training.

- 9 This proposal is an interim measure until the Government Rules of Sourcing are updated and the work programme to achieve broader outcomes through government procurement is implemented. Furthermore, the Ministry is working with relevant agencies to understand how government can leverage its construction procurement to create a more sustainable construction market that reduces the risks of boom and bust cycles in the industry.

Issues in the construction industry

- 10 In August 2018, the Minister for Building and Construction, the Minister for Infrastructure, and the Minister of Housing and Urban Development met with Construction industry leaders to discuss the status of the construction industry in New Zealand and the role of government procurement. A high level summary of the construction sector and the issues it faces is attached as Annex 1.
- 11 One of the topics that has received media attention is that the New Zealand construction industry is under increasing pressure, even during a period of increasing construction activity.
- 12 Recent media reports on this topic include Fletcher Building, which has announced \$322 million of losses in February 2018, mainly from large government construction projects such as the International Convention Centre in Auckland and the Justice Precinct in Christchurch. More recently, Ebert Construction Ltd (Ebert) went into liquidation owing as much as \$40 million. Ebert's projects included the Indian High Commission's new headquarters in Wellington, the Union Green Apartment development in Auckland and a unit at Middlemore Hospital.
- 13 Current government construction procurement is contributing to this situation. In particular, the construction sector reports that government construction procurement is inconsistent across agencies. For example, some agencies focus on lowest cost model, while some agencies transfer more risk to suppliers rather than allocating risks to the party in the best position to manage them.¹
- 14 The Government is a major procurer of commercial construction. As such, it should lead and set expectations for how the sector operates and what is best practice. To help address these issues and provide more certainty around government construction procurement contracts, we agreed that government agencies should adhere more closely to the Guidelines.

Government procurement in New Zealand

- 15 Government procurement in New Zealand is centre-led rather than centralised. The majority of government procurement is undertaken by individual government agencies. The main accountability and responsibility for government procurement, particularly for construction and infrastructure projects, rests with the Chief Executives of each government agency.
- 16 The Ministry is responsible for developing government procurement policy framework. The policy framework aims to support and encourage good procurement practice that delivers good commercial outcomes. It is up to individual government agencies to implement and follow the framework.
- 17 Part of this framework are the Ministry's Guidelines for construction procurement that comprise the following five documents:
- A guide to developing your procurement strategy.

¹ Risk is often transferred to suppliers through "design and build" contracts, where specifications are given and construction companies are expected to design and build the project at a fixed price. This process increases contract complexity and reduces margins for construction firms.

- A guide to matching capability to complexity.
 - A guide to risk and value management.
 - A guide to health and safety and employment standards at work.
 - Achieving construction productivity gains by adopting Building Information Modelling.
- 18 The Guidelines were developed by the Ministry in conjunction with the construction industry in 2015 to:
- modernise the Government's approach to construction procurement to align with good international practice and provide better value for the New Zealand public;
 - encourage government agencies to take a strategic approach to construction procurement;
 - encourage agencies to consider whole of life costs and outcomes;
 - show linkages to the construction project management lifecycle; and
 - show linkages to other Government-directed requirements (e.g. Better Business Cases).
- 19 The construction industry is very supportive of these Guidelines and has indicated that the Guidelines address their immediate concerns about government construction procurement.
- 20 In particular, the Guidelines recommend consideration of the whole-of-life costs and outcomes of projects, encourage government agencies to take a strategic approach to construction procurement and show linkages to other government requirements. The Guidelines also encourage agencies to share the risks and benefits of projects appropriately.
- 21 In addition, the industry groups have indicated that Guidelines help streamline the procurement process and move agencies away from bespoke procurement that increase complexity and tendering costs.
- 22 The Guidelines are currently only voluntary and are intended to complement other procurement policies and rules, such as the Government Rules of Sourcing (the Rules) which are mandatory for Public Service Departments and most Crown entities and agencies. The fact that the Guidelines are voluntary means that we currently have little oversight over whether government departments and agencies are following the Guidelines apart from feedback from the construction industry.

Construction skills development and training

- 23 Current procurement practices do not incentivise employers to take on apprentices or invest in training and developing their current workforce, as well as risking allowing competitors who do not invest in training their workforce to undercut those who do and the exploitation of vulnerable workers.
- 24 The Ministry is already working with the industry to develop a Construction Skills Strategy and supporting Action Plan. Part of this Action Plan will be to leverage government procurement to improve skills training and workforce development in the domestic construction industry. The Economic Development Cabinet Committee approved the Construction Skills Action Plan on 12 September 2018 [DEV-18-MIN-0187 refers].
- 25 We can use this opportunity to instruct departments and agencies to consider how they can leverage their large construction projects to encourage suppliers to invest in the skills development and training of their workforce.

- 26 In doing so, the Government can help address the skills shortage in construction, and help improve capability and productivity.

Letter from Ministers and longer term initiatives to address the issues raised

- 27 This paper recommends that Government Ministers write to the heads of their relevant departments and agencies (using the attached template at Annex 2) instructing them to:
- adhere to the Guidelines where practicable;
 - demonstrate that they have considered the good practice guidance in the Guidelines; and
 - to begin thinking about how they can use their construction projects to support skills development and training.
- 28 We note that the letter is an interim measure. The Ministry is currently reviewing and updating the Rules. That work exploring proposed changes to the Rules will include a rule formalising a requirement for agencies to consider the Guidelines as part of construction procurement and provide evidence that the Guidelines were considered.
- 29 In addition, the Department of Corrections has also been leading a Crown Collaboration Construction Forum² with officials from the major procurers of construction and infrastructure across government to create a pipeline of upcoming government projects. Officials will continue to work with this forum and other relevant agencies to understand how government can leverage its construction procurement to create a more sustainable construction market. The objective is to help reduce the risks of boom and bust cycles in the industry.

Relationship to the other outcomes that can be achieved through Government Procurement

- 30 The Ministry is also working on the leveraging government procurement work programme to achieve broader outcomes, which includes increasing the size and skill level of the construction sector workforce.
- 31 The other broader outcomes to be considered in the wider work programme on government procurement are:
- increasing New Zealand businesses' access to government procurement;
 - improving working conditions by ensuring compliance with employment standards, and health and safety, requirements through supply chains; and
 - Transitioning to a net zero emission economy.
- 32 The intention is to require consideration of these broader outcomes in government procurement by including them in the updated Rules as well.
- 33 We recognise that government procurement cannot target every economic, environmental, social and cultural outcome in every contract. There is a risk that by trying to incorporate every possible outcome there is a lack of accountability and focus. In addition, cost will always be an important factor in any procurement.
- 34 To address this issue, work is underway to understand how these outcomes can be prioritised. Once prioritised, objectives can be leveraged depending on the type of procurement taking place.

² Agencies involved in this group are Corrections, Ministry of Business, Innovation and Employment, Ministry of Health, Treasury, New Zealand Transport Agency, Ministry of Education, Ministry of Defence, New Zealand Defence Force.

- 35 Specifically targeting sectors of procurement avoids overloading any one industry or government contract with too many additional outcomes. This also enables agencies to pilot and improve on new procurement approaches before scaling up. Agencies can continue to voluntarily leverage additional outcomes, but the new Rules, when agreed, will require agencies to leverage the set priorities.

Risks

- 36 The issues facing the construction sector are varied and complex, of which construction procurement is only one element. Further action will be required to help address the other issues otherwise there is the risk that the industry will remain constrained. To address this risk, the Government is already working on its broader outcomes in procurement, as noted above, and will continue to work with the industry on improving its longer term sustainability.
- 37 One of the main challenges with this programme of work is to ensure expectations are realistic of what can be delivered through procurement while still achieving good commercial outcomes. Additional requirements will likely require agencies to consider appropriate 'trade-offs' between getting the best price and achieving other objectives such as a more sustainable construction sector.
- 38 For example, leveraging construction projects to improve construction workforce skills development may increase up-front costs, impact delivery times or result in additional legal input and contract management effort. These initial costs, however, would be balanced out by wider benefits, such as a more sustainable and productive construction sector. We would also expect to see better value-for-money for taxpayers over the lifetime of projects with the construction of infrastructure that requires less maintenance and repair.
- 39 Finally, the majority of construction contracts are in the private sector with central government contracts making up 18% of the market. The relatively small market share of government contracts may limit the effects of direct Government action. However, the Government is still in the position to take leadership on the issue and set good procurement standards for the rest of the market.

Consultation

- 40 The State Services Commission and the Treasury were consulted on this paper and the Department of Prime Minister and Cabinet has been informed.

Financial Implications

- 41 There are no direct financial implications associated with writing to government departments and agencies instructing them to adhere to the Guidelines.
- 42 There may be increases to construction project costs in the future as agencies move away from the lowest cost model. Any increase in costs should be offset by better overall value-for-money in projects, better sharing of risks and benefits, and a more sustainable construction industry.

Legislative Implications

- 43 This paper has no legislative implications.

Impact Analysis

- 44 This paper does not require an impact analysis.

Human Rights

45 This paper does not have Human Rights implications.

Gender and Diversity Implications

46 This paper does not have any direct gender or diversity implications.

Publicity

47 We propose publicity of this action to support the construction industry after Ministers have written to their departments and agencies.

Proactive Release

48 This paper will be proactively published subject to redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister for Economic Development and the Minister for Building and Construction recommend that the Committee:

1. **Note** that government procurement for construction and infrastructure projects in New Zealand is decentralised with primary responsibility and accountability sitting with the Chief Executives of government agencies;
2. **Note** that the construction industry in New Zealand is facing a number of issues including complex and expensive procurement processes, inappropriate transfer of risks to suppliers, and low margins;
3. **Note** that these issues have contributed to recent high profile failures in the industry;
4. **Note** that the Government has a responsibility to use its market share to set expectations and best practice in construction procurement;
5. **Note** that the Government Construction Procurement Guidelines, developed in conjunction with the industry in 2015, would help address the issues identified;
6. **Note** that the Government can also use this opportunity to instruct agencies to consider how to support skills development and training as part of construction procurement;
7. **Agree** to Ministers writing to the heads of their relevant departments and agencies (using the attached template at Annex 2) requesting them to:
 - a) adhere as much as practical to the Guidelines; and
 - b) consider how they can use their construction projects to support skills development and training.

8. **Note** that this is an interim measure while the Ministry of Business, Innovation and Employment updates the Government Rules of Sourcing and continues its work programme to achieve broader outcomes through government procurement.
9. **Agree** to an announcement to be made about the Government's actions to support the construction industry after Ministers have written to their respective agencies.

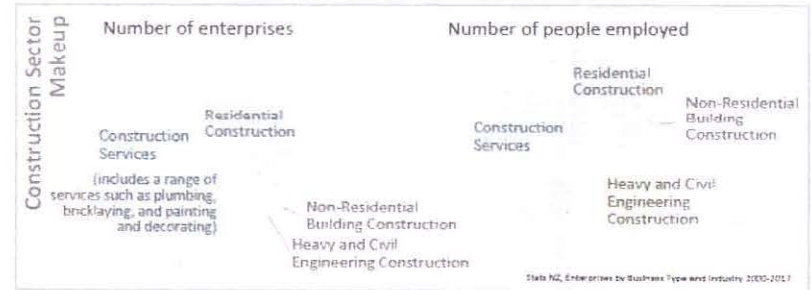
Authorised for lodgement

Hon David Parker
Minister for Economic Development

Hon Jenny Salesa
Minister for Building and Construction

PROACTIVELY RELEASED

Construction is a unique part of New Zealand's economy. It is:



Construction is a complex sector with existing issues:

Skills and labour shortages:

- Struggles to attract and retain staff across all components (labour, trades, professions and management)
- Relies on sub-contractor model to manage boom-bust uncertainty, rather than developing people in-house
- Decline in apprenticeships

Low productivity

- Low investment in research and development and limited adoption of innovation
- Fragmentation of the sector means missed opportunities for economies of scale, efficiency through standardisation
- Inefficiencies in the building consenting process can cause delays

High costs for building products, land and skilled labour

- A number of factors drive high costs for construction projects, including capacity constraints driving labour costs
- Regulatory settings and practices make it easier for 'tried and true' products than new ones

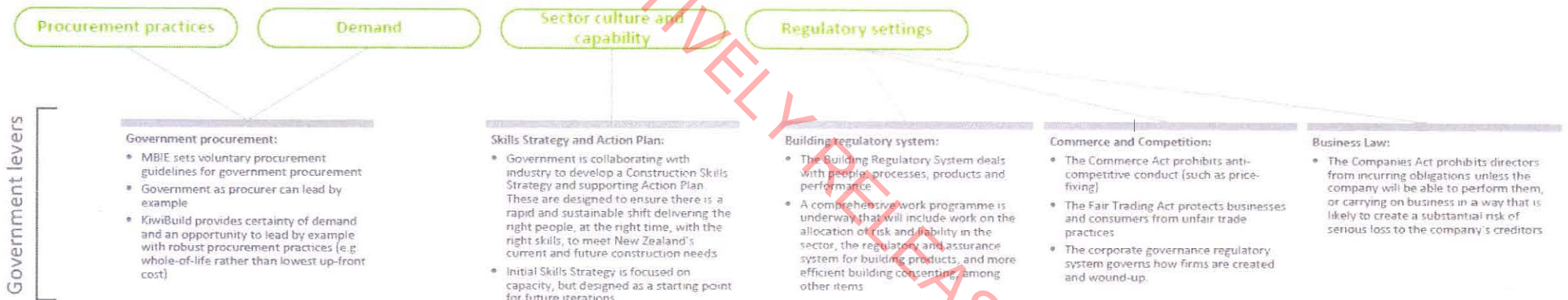
Reports from sector are of slim margins

- Construction cost inflation has been forecast to be 4.6 per cent in 2019, significantly above the general rate
- Many commercial construction projects are high-risk, with sector players reporting narrow profit margins

Variable procurement and project management capability and practice

- The price for work is often fixed at procurement stage, but costs can balloon during construction
- Procurement practices by Government and the sector are perceived to drive to lowest cost rather than whole-of-life costs

These issues are influenced by:



Opportunities for discussion:

- ### 1 Government procurement

Government is a major procurer of commercial construction. As such, it should lead and set expectations for how the sector operates.

 - Government is both a major procurer of construction work, and sets the rules and processes for procurement. The Government plays a lead role in setting expectations for how the sector operates.
 - What changes to the Government's approach to procurement could drive a positive transformation in the construction sector?

Examples of opportunities you could raise: create a clearer view of the project pipeline; actively consider sector sustainability in the tender process; make the Government procurement guidelines mandatory; improve sharing of best practise procurement processes

Next steps: ask MBIE to explore options to give effect to these changes.
- ### 2 Sector capability

Ensuring the Construction Sector has the right people, at the right time, with the right skills will involve not just sufficient labour, but also high-end skills such as project management, procurement and digital modelling to meet the needs of a changing sector. Delivering this capability will require both short- and long-term action by both government and industry.

 - What capability does the sector need to better identify, scope and manage commercial risks in the procurement process?
 - How can Government best support the sector to achieve that, both in the short and long term?

Examples of opportunities you could raise: focus Skills Action Plan on procurement and project management; provide information and guidance on risk management; provide guidance to improve capability of procurers (both Government and private sector)

Next steps: ask MBIE to explore options to give effect to these changes.
- ### 3 Sector composition and operation

The Government has a role in supporting a healthy, adaptable, competitive and innovative sector. There are a range of regulatory and legislative settings that contribute to shaping how the sector is configured and how it operates.

 - What are the key challenges for the sector in achieving a sustainable business composition?
 - What critical changes to the wider regulatory and legislative environment could be made to enhance sustainability?

Examples of opportunities you could raise: identify critical changes to regulatory settings that would enhance sustainability of firms (e.g. consider Health and Safety, Building Act, and commercial regulatory settings); develop a joint sector/Government view of the ideal future composition of the sector

Next steps: ask MBIE to explore options to give effect to these changes

Annex 2 – Draft letter

XX September 2018

Respondent
Respondent's address

Dear [Name/Title]

Immediate changes to the procurement of construction projects

As the Minister responsible for [this agency / the board of this Crown Entity] I am writing to you to inform you of upcoming changes to the Government Rules of Sourcing that will affect the procurement of new construction projects. It is my expectation that your organisation will now begin to implement the new requirements in relation to the Construction Guides, and skills development and training in anticipation of the formal changes.

Construction procurement across government agencies has been inconsistent, resulting in instances of poor practice such as a lowest cost approach to procurement as well as inappropriate transfer of risk, among other issues. There is a risk that poor practice could contribute to current stresses and failures in the construction industry.

Government agencies are in the position to use their capital investment to take the lead in setting good construction procurement practice. This is an important issue, as partnership with the construction industry is key for the delivery of many of the Government's priorities, including housing and KiwiBuild, health, education, transport and regional development.

Construction Procurement Guidelines

The Ministry of Business, Innovation and Employment has a set of Construction Procurement Guidelines (Guidelines) to assist government agencies procuring construction works. These Guidelines were developed in conjunction with the construction industry.

The construction sector has commented that consistent use of these Guidelines would have a positive effect on the sector as a whole. Therefore, the Government Rules of Sourcing will be updated to include a new rule requiring agencies to consider the Guidelines when procuring construction works and be able to provide evidence that they have been considered.

These Guidelines are already available on the New Zealand Government Procurement website.³ I expect your agency to refer to these Guidelines for your upcoming construction procurement projects and be able to demonstrate that your agency has considered the good practice guidance set out in them.

Skills development and training

Government has the opportunity to leverage its large construction projects to encourage businesses to develop their people and help to address the current skills shortage in New Zealand. A tendency to favour the lowest cost bid has resulted in suppliers who do not invest in training and developing their workforce being able to undercut those that do, thereby disincentivising suppliers from investing in the domestic construction workforce. To address this issue, Cabinet has agreed in principle for the Ministry of Business, Innovation

³ <https://www.procurement.govt.nz/procurement/specialised-procurement/construction-procurement/>

and Employment to undertake work to make skills training and development a requirement across government procurement.

The Government expects this requirement to come into effect next year. The Ministry of Business, Innovation and Employment will provide agencies with guidance including how to evaluate training commitments put forward by suppliers before this time. However, in the interim, I ask that you use your construction projects to encourage skills development and training.

I ask that you please ensure that everyone in your agency is aware of the expectation that that construction guidelines will be considered for all procurement of new construction from this point onwards and start to think about how upcoming construction projects can be used to develop skills and training.

By taking a consistent approach to construction projects and focusing on value for money, not lowest cost, we can partner more effectively with the construction sector to address these issues and deliver value for New Zealand.

Yours sincerely

Name

Title

PROACTIVELY RELEASED

Dear [Name]

Use of the Construction Procurement Guidelines and construction workforce skills development and training

Attached are letters Cabinet agreed for Ministers to send to the Chief Executives and Heads of relevant departments and Crown agencies.

With a number of competing priorities on what procurement should be used to achieve, we took a paper to Cabinet on 23 October where four priority outcomes were agreed [CAB-18-MIN-0516.1 refers]. Cabinet agreed that skills development and training will be a focus for construction projects and will be a requirement for these contracts. This step reinforced the decision of Cabinet on 8 October that Ministers write to the heads of their relevant departments and agencies requesting them to:

- adhere as much as practical to the Construction Procurement Guidelines; and
- consider how they can use their construction projects to support skills development and training [CAB-18-MIN-0479 refers].

The attached letter informs Chief Executives and Heads of your relevant departments and Crown agencies of these two Cabinet decisions. Government is in a position to leverage its capital investment spend to take a leadership role and set the standards for best practice in construction procurement.

The most immediate step we can take to increase consistency across construction procurement is to get government agencies to adhere more closely to the Government Construction Procurement Guidelines (the Guidelines).

To drive real change and accountability within government, we need to ensure that agencies measure and report progress and participation in this space. The Ministry of Business, Innovation and Employment will be developing a reporting framework. Once a baseline has been established I will be monitoring how agencies are tracking against this.

A requirement for agencies to consider skills development and training in their construction procurement and to adhere as much as practical to the Procurement Construction Guidelines will come into effect next year.

Yours sincerely

Hon David Parker
Minister for Economic Development

Hon Jenny Salesa
Minister for Building and Construction

Respondent

Respondent's address

Dear [Name/Title]

Immediate changes to the procurement of construction projects

As the Minister responsible for [this agency] I am informing you of the opportunities available in respect of the procurement of new construction projects.

With a number of competing priorities on what procurement should be used to achieve, the Minister for Economic Development and Minister for Building and Construction took a paper to Cabinet on 23 October where four priority outcomes were agreed [CAB-18-MIN-0516.1 refers]. Cabinet agreed that skills development and training will be a focus for construction projects and will be a requirement for these contracts. This step reinforced the decision of Cabinet on 8 October that Ministers write to the heads of their relevant departments and agencies requesting them to:

- adhere as much as practical to the Construction Procurement Guidelines; and
- consider how they can use their construction projects to support skills development and training [CAB-18-MIN-0479 refers].

We want to take this action because Government agencies are in the position to use their capital investment to take the lead in setting good construction procurement practice. To drive real change and accountability within government, we need to ensure that agencies measure and report progress and participation in this space. The Ministry of Business, Innovation and Employment will be developing a reporting framework. Once a baseline has been established, the Minister for Economic Development will be monitoring how agencies are tracking against this.

Skills development and training

Government has the opportunity to leverage its large construction projects to encourage businesses to develop their people and help to address the current skills shortage in New Zealand. A tendency to favour the lowest cost bid has resulted in suppliers who do not invest in training and developing their workforce being able to undercut those that do, thereby disincentivising suppliers from investing in the domestic construction workforce. To address this issue, Cabinet has agreed that skills training and development will be a requirement in Government construction projects.

The Government expects this requirement to come into effect next year. The Ministry of Business, Innovation and Employment will provide agencies with guidance including how to evaluate training commitments put forward by suppliers before this time. However, in the interim, I expect that you will use your construction projects to encourage skills development and training.

Construction Procurement Guidelines

Construction procurement across government agencies has been inconsistent, resulting in instances of poor practice such as a lowest cost approach to procurement as well as inappropriate transfer of risk, among other issues. There is a risk that poor practice could contribute to current stresses and failures in the construction industry.

The Ministry of Business, Innovation and Employment has a set of Guidelines to assist government agencies procuring construction works. The Guidelines were developed in conjunction with the construction industry, and are available on the New Zealand Government Procurement website.

The construction sector has commented that consistent use of these Guidelines would have a positive effect on the sector as a whole. The Government Rules of Sourcing will be updated to include a new rule requiring agencies to consider the Guidelines when procuring construction works and be able to provide evidence that they have been considered.

I ask that you ensure that everyone in your agency is aware of the expectation that upcoming construction projects will be used to develop skills and training and that the construction guidelines will be considered for all procurement of new construction from this point onwards.

Yours sincerely

Name

Title

PROACTIVELY RELEASED