Item 6

2nd November 2022

Glasgow City Council

Finance & Audit Scrutiny Committee

Report by Executive Director Neighbourhoods, Regeneration and Sustainability

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COUNCIL CAPITAL PROGRAMME – CONSTRUCTION SECTOR VOLATILITY & THE EFFECTS ON INFLATION

Purpose of Report:

To advise Committee: on the ongoing challenges of hyper-inflation within the construction sector, caused in-part by Covid-19, Brexit, the war in Ukraine and other market factors; how this is affecting delivery of the Council's Capital Programme; and to provide an overview of actions / options being considered, which could mitigate the challenging market conditions resulting in successful procurements and awarding of construction contracts.

Recommendations:

It is recommended that Committee:

(1) Note the contents of the report.

Ward No(s): Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

1 BACKGROUND

1.1 For some time now, Council officers have been tracking the impact that the disruption of global supply chains is having on the construction sector, for which there is a constantly evolving picture as local economies are recovering from the Covid-19 pandemic. Resulting uncertainties have been further compounded by Brexit and the 2021 Suez Canal blockage, which have led to shortages within global supply chains of key components and raw materials (such as semi-conductors, steel, copper, etc). More recently, the conflict in Ukraine and soaring energy costs have also significantly affected the cost and availability of building materials. Given all these factors, the construction sector is facing unprecedented inflation and cost volatility.

1.2 Officers from across the Council have been monitoring the situation via direct engagement with the supply chain, National Government, national procurement forums and industry / construction leadership bodies (Construction Leadership Council and Scottish Construction Leadership Forum), as well as through intelligence coming from various market analyses. This has confirmed the following points:

a. The sector is experiencing shortages of both skilled labour and materials. It is anticipated that these shortages, longer lead times and steep price increases, will continue to impact construction projects for at least another 2 to 3 years (possibly longer).

b. Recent procurement activity nationally has substantiated predictions. There is increasing evidence of tenders being returned significantly above initial budget estimates (the percentage increases are directly linked to the commodity types, and skills required for each project), which is adding considerable pressure to budgets that do (or did) not, have contingency allocations to cover these increases. Additionally, there are instances where procurements have had to be deferred, and in some cases terminated, due to excessively high / unaffordable tender costs.

c. Furthermore, cost volatility and material insecurity issues have resulted in some bidders being unable to guarantee prices beyond a very short period (for example, structural steel prices that used to be open for acceptance for period of 30 and 60 days are now being held for only 24 hours before requiring re-pricing), with several additional requests made for contracting authorities, such as Glasgow City Council, to apply uncapped post-award price adjustments with inflation. This is an approach that is unpalatable due to the increased exposure to risk and high levels of cost uncertainty that would ensue.

1.3 The following sections of the report outline how this is affecting delivery of the Council's Capital Programme and provides an overview of actions / options being considered which could manage and mitigate the situation.

1.4 This report was presented to Neighbourhoods, Housing & Public Realm City Policy Committee on 27th September 2022. The link to the submitted report is noted as follows:

https://www.glasgow.gov.uk/councillorsandcommittees/submissiondocuments.asp?submissionid=105979

1.5 Having considered the matters presented in the report, Committee recommended that it also be referred to Finance & Audit Scrutiny Committee for consideration.

2 CONSTRUCTION POLICY NOTE (CPN) 03/2021 AND 04/2021

2.1 In response to the situation outlined, the Scottish Government published Construction Procurement Notes 03/2021 and 04/2021, procurement-based construction policy notices which set out measures for contracting authorities to manage and mitigate market pressures affecting the availability and affordability of construction sector resources.

2.2 The CPN guidance has two main areas of focus: in-flight or imminent construction contracts; and pipeline projects that are in development or at procurement stage.

2.3 In the case of in-flight contracts, recommended approaches are based on engagement and negotiation between parties, with a focus on the avoidance of contractual conflict where possible. Contracting authorities are encouraged to work closely with contractors to identify how risk to the delivery of projects is adversely affected by resource constraints, and how these risks might be mitigated.

2.4 Where contractors are reporting unprecedented difficulties associated with the challenges outlined previously, the CPN recommends the following actions:

- Examination of the terms and conditions which apply if the contractor fails to deliver on time, and to specified requirements.
- Eliciting of clear evidence from the contractor for the reason for cost increases, delay and disruption to the project.
- Evaluation of requests for relief or waiver of time and/or financial consequences in relation to the standard of evidence and details of the cause of any issues as required by contract.
- Legal advice should be sought as and when is necessary.
- Liaising with main contractors to evaluate the impact of labour and materials shortages on the delivery of construction projects.
- Implementing inspection and assurance measures as required to address any related risks to the specification and workmanship required by contracts

2.5 For pipeline projects that are in development or at procurement stage, contracting authorities are being encouraged to review and update their capital

programme plans based on the parameters of affordability and deliverability. This approach requires detailed assessment and discussion on whether contracts can be delivered as originally planned, and perhaps to set values at which progressing the projects may require to be reviewed.

2.6 Contracting authorities also need to assess where value engineering is appropriate to reduce costs, or when additional funds might be required to enable pipeline projects to progress, and regrettably, identify any projects that may require to be shelved. The CPNs also stresses that abortive tendering should be avoided where possible.

3 GLASGOW CITY COUNCIL – LIVE CONTRACTS AND PROCUREMENTS

3.1 The following section of the report provides a high-level overview of the Council's current Capital Programme in terms of live infrastructure construction contracts and procurements, as well as procurements that will be progressed during the next 12-month period. This comprises capital projects that are being delivered as Business-as-Usual (i.e. designed and delivered using Glasgow City Council resources and ALEOs) and as part of City Deal Infrastructure Investment Programme:

- The Capital Programme currently consists of 39 in-flight infrastructure construction contracts, of which 33 are being delivered as Business-as-Usual, and 6 are part of the City Deal Infrastructure Programme. The combined value of these contracts exceeds £400M.
- An additional 19 infrastructure related procurements are currently being progressed and are anticipated to reach contract award in the next 12 period. Of the 19 procurements, 9 are Business-as-Usual and 10 relate to the City Deal.

3.2 It should be noted that the figures outlined above could be subject to change as a result of the implementation of CPN 03/2021 and CPN 04/2021 recommendations. This could result in fewer contracts being delivered as part of the Council's Capital Programme. It is also likely that contract values will be revised, and that outturn costs will be higher than initially expected.

3.3 In terms of the City Deal programme, plans were revised during late Summer / early Autumn 2021 as part of the post-Lockdown recovery process. The updated programme (Revision 9) responded to all known financial implications at that stage as well as security of supplies and contractor availability. This version was developed as a joint effort between internal Council departments (Neighbourhoods, Regeneration & Sustainability, Legal, Finance and Procurement), as well as a range of external partners, which included contractors and suppliers.

3.4 The uncertainty of the situation and the pace at which market conditions evolved were such that elements of the Revision 9 programme had to be revisited immediately following approval by the Glasgow City Region in late October 2021. For example, reports were presented to both the Council's City Administration

Committee (2nd December 2021) and the Glasgow City Region Cabinet (7th December 2021) to manage cost increases for the Govan-Partick Bridge, which had emerged during the design and procurement phases of this City Deal funded project.

3.5 In order to deal with the cost increase Committee agreed to defer 8 other City Deal projects. This was necessary to ensure that the overall City Deal Infrastructure investment programme could continue to be delivered within the limits of the approved City Deal budget. The process of identifying the 8 projects required a significant amount of work to ensure compliance with both the Glasgow City Region Programme Assurance Framework and the HM Treasury Green Book model. This involved:

- a prioritisation exercise of projects, which considered: development and design status; deliverability within current programme timescales; strategic fit / importance; and options to deliver via additional funding mechanisms; and
- a full economic impact assessment.

3.6 Depending on the scale of cost increases which could affect the City Deal Infrastructure Investment Programme in the year(s) ahead, it may be necessary to carry out further prioritisation exercises and economic impact assessments. It should be noted that these would need to be considered and approved by both the Council's City Administration Committee and the Glasgow City Region Cabinet prior to contracts being awarded.

4 GLASGOW CITY COUNCIL – ADDITIONAL MITIGATION AND OPTIONS

4.1 Council officers from across Neighbourhoods Regeneration & Sustainability, Legal, Finance and Corporate Procurement Unit have been exploring options that could also help to mitigate the current challenges and facilitate successful procurement and award of construction contracts. This has included:

- Continued market research and engagement with the supply chain, National Government, national procurement forums and industry / construction leadership bodies – to better understand emerging challenges and opportunities;
- Consultation and engagement with National Government, other Scottish Local Authorities, national procurement forums and industry / construction leadership bodies – to share best practice and experience;
- Value engineering of designs, considering scope reduction and use of alternative materials; and
- Review of procurement options and routes to market.

4.2 Additionally, market engagement with local stone suppliers has validated assumptions that direct purchasing of materials outwith the main construction contract could help reduce overall project costs. Mechanisms for this are currently being explored, which could include the establishment of a dedicated stone supply framework, or the use of standalone materials contracts. Whilst

there is general acceptance that this approach should be considered, it is not a short-term solution and will require officer time and resource to establish.

4.3 Various legal options and remedies have also been identified, that can be employed as appropriate to help ensure procurements in development can continue whilst maintaining best value for the Council. A number of options are available, dependent on the type on contract, including:

- Off-Site Materials Agreements to allow contractors to purchase specific materials on contract award and be paid for such at this stage, rather than when the materials are incorporated into the works.
- Liability caps on indemnity insurances – market research has indicated that uncapped liability is unacceptable to the current market. Accordingly, consideration is being given to capping contractor's liability based on the level of risk in the works being procured.
- Price fluctuation clauses for specific materials – this would allow for some agreed level of increase in the price of materials which are particularly susceptible to market price volatility from tender date to a specified time post-contract award, to allow for a share in the risk of increased pricing for materials post-tender between the Council and the Contractor.
- Increased levels of Performance Bonds to give the Council more protection in the event of contractor insolvency.

4.4 Each of the above requires to be considered on a contract-by-contract basis and is dependent upon the level of inherent risk in the works being procured and the materials required.

5 Policy and Resource Implications

Resource Implications:

Financial:	Financial implications associated with these issues cannot be determined in full and will be monitored on an ongoing basis.
Legal:	Legal implications are considered on a contract-by-contract basis. Legal resources to support this are already in place.
Personnel:	There are no direct personnel issues.
Procurement:	There are dedicated resources already in place within the Council's Corporate Procurement Unit to support all relevant procurement activities.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2021-25? Please specify.	Yes, projects being delivered through the Capital Programme will support people with protected characteristics by: Tackling poverty; Reducing health inequality; and Empowering communities.
What are the potential equality impacts as a result of this report?	Any impacts will be positive.
Please highlight if the policy/proposal will help address socio-economic disadvantage.	The Capital Programme (including the City Deal Infrastructure Investment Programme) has been developed with consideration given to improving the socio-economic context of the city. The programme has a firm Inclusive Growth emphasis to extend labour, education, housing, employment and business opportunities.

Climate Impacts:

Does the proposal support any Climate	Projects delivered through the Capital Programme will directly contribute to the

Plan actions? Please specify:	delivery of the following Climate Plan actions: 5; 36; 40; 51; and 56.
What are the potential climate impacts as a result of this proposal?	Projects being delivered as part of the Capital Programme will have a positive climate impact by: • Increasing the resilience and adaptive capacity of new and refurbished assets. • Increasing resilience to flooding and sea-level rise. • Facilitating a modal shift to sustainable and active travel. • Using green-infrastructure to support mitigation and adaptation. • Developing green-skills through the delivery of new jobs, training and apprenticeships.
Will the proposal contribute to Glasgow's net zero carbon target?	Projects being delivered as part of the Capital Programme have been developed to promote the net-zero agenda and facilitate low carbon development. Contractors are obliged to minimise carbon footprint during the construction phase, and to use low-carbon materials where possible.
Privacy and Data Protection Impacts:	There are no Privacy or Data Protection matters associated with this report.

6 Recommendations

6.1 It is recommended that Committee:

(1) Note the contents of the report.