

# Agile Procurement in the Water Sector

Supporting New Zealand's economic recovery  
through faster, better and smarter procurement

3 June 2020

## **The COVID-19 Local Government Response Unit**

Department of Internal Affairs  
Local Government New Zealand  
Society of Local Government Managers  
National Emergency Management Agency



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# 1. Executive Summary

With over \$18bn of identified investment in the May 2020 budget, infrastructure is a key part of the Government's response to support New Zealand's economic recovery from COVID-19. A key success factor in the recovery will be the ability to mobilise a range of projects quickly and effectively throughout New Zealand. The Construction Sector Accord recently provided recommendations on how to rapidly mobilise the delivery across many sectors. In parallel to this advice, the COVID-19 Local Government Response Unit (comprising the Department of Internal Affairs (DIA), Local Government New Zealand (LGNZ), the Society of Local Government Managers (SOLGM) and the National Emergency Management Agency (NEMA)) has identified that strategic guidance should be provided to assist in the delivery of water infrastructure projects and services.

This guidance has been socialised within the Water Sector Working Group, Local Government, the New Zealand Infrastructure Commission, the Office of the Auditor General and the Ministry of Business, Innovation and Employment (MBIE) to ensure alignment of principles and practices and identify pragmatic examples that are already being utilised in the sector.

The purpose of this paper is to raise the awareness of the need to adapt procurement practices and signal the support needed in Local Government of Chief Executives, Mayors and procurement professionals to champion these new strategies, practices and buying behaviours to support New Zealand's economic recovery.

The following high-level conclusions and recommendations were formed:

**Conclusion 1:** Water infrastructure is a good candidate for stimulatory investment given there is a clear need for enhancement of infrastructure as identified in the Three Waters Review. Many water projects can be mobilised relatively quickly, are small in project value, including renewals and planned maintenance projects. A large proportion of the projects do not require consenting or land acquisition and thus can be commissioned quicker.

**Conclusion 2:** As a result of the COVID-19 disruption, an already fragile construction sector is now facing pressures in terms of:

- Financial sustainability;
- More stringent and onerous health and safety working practices that will add to delivery costs and timescales;
- A lower project risk appetite in a fragile construction sector and therefore risk uncertainty will be priced into tenders and may not be attractive to suppliers to even bid;
- Closed international borders that will impact the supply chain and the available workforce, already noting that some steep cost escalation is already occurring;
- High potential for escalation of projects costs as a result of the above, and the need for increased contingency provisions; and
- Limited capacity to deliver projects as the sector is experiencing a significant downturn in private sector demand.

Local Government relies on the construction sector to deliver water services and it needs to recognise that the conditions above have potentially turned the market from a 'buyers' market to a 'sellers' market and the project risk profile is changing considerably.

**Conclusion 3:** The water sector has historically applied good procurement practices with competitive tendering, risk adverse approaches as identified in the May 2020 paper produced by the Office of the Auditor General *Local government procurement*. The sector has historically adopted some progressive procurement delivery models including the Watercare Enterprise Model and the Stronger Christchurch Infrastructure Rebuild Team (SCIRT). However, there is still excessive focus on tendering individual projects rather than bundling them into programmes of works, awarding contracts based solely on price and pushing the risk profile for the suppliers to absorb.

**Conclusion 4:** New Zealand procurement rules are very flexible allowing for, amongst others, single sourcing, Early Contractor Involvement (ECI), strategic partnerships as well as more conventional tendering. Local Government has even more flexibility than Central Government. One of the main constraints to Local Government adopting a more efficient approach to procurement is driven by cultural inertia and inherited custom and practices.

**Conclusion 5:** Local Government is facing a challenging financial and operating environment, therefore, demonstrating value for money, effective risk management and efficient delivery of services will be of increasing importance.

**Recommendation 1:** Where it makes sense, Local Government needs to adjust its procurement practices to utilise this market intelligence to develop agile procurement strategies and utilise the relevant procurement levers to achieve its outcomes. In assessing potential procurement strategies that could be adopted the following levers were identified (see below). The levers can be used on an individual basis but ideally a combination of some or all of them are adopted by councils to deliver outcomes in these unprecedented times. The New Zealand Construction Procurement Guidelines contain guidance and can be used to support the move to more strategic methods of procurement as those identified below. The Construction Sector Accord is currently developing a Construction Procurement Playbook focussed on rapid delivery and building on existing good practice to streamline processes and avoid common pitfalls in construction projects

Lever	Overview
<b>1. Long Term Investment Planning</b>	Extend the planning horizon and develop multi-year project pipelines across the sector to develop a sustainable industry and develop sector confidence based on councils' Long-Term Plans covering capital renewals, planned maintenance and new project pipelines.
<b>2. Develop Consolidated Programmes of Work</b>	Bundle projects into programmes of works, or even programmes of works across councils where appropriate, to help the sector deliver better value for money through synergies and economies of scale.
<b>3. Efficient Resource and Capacity Management</b>	Improve understanding of the market through proactive engagement with suppliers and increase pipeline visibility to assist the sector resource and capacity plan.
<b>4. Water Reform Agenda</b>	Introduction of the Water Regulator to address historical water infrastructure problems therefore potential tied funding could be available in the future to support potential efficiencies.
<b>5. National Water Delivery Alliance</b>	Consider options for cohesive and joined up contracting practices, on a national or regional basis, to accelerate the speed of the infrastructure programme delivery and leverage resources across Local Government.
<b>6. Maximise Existing Contractual Arrangements</b>	Leverage existing arrangements such as panels of suppliers, standard forms of contracts and the outcomes-based framework to reduce costs, remove duplication of effort and simplify approach to contracting.
<b>7. Alternative Procurement &amp; Delivery Models</b>	Use alternative procurement and delivery models based on the characteristics of a given project (i.e. scale, complexity and risk) to improve outcomes and public value.
<b>8. Enhance Procurement Capability</b>	Enhance strategic procurement capability including market intelligence, understanding of alternative delivery models and the associated assessment frameworks, through knowledge sharing, coaching and resource sharing.

**Recommendation 2:** When evaluating procurement outcomes in these challenging times, consideration should be taken to both the wider market dynamics and the broader outcomes. The assessment should therefore consider the supplier market attributes including supplier financial sustainability and historical project performance, supply chain resilience and direct procurement, whilst working under the value for money and financial regulations of the Local Government Act.

**Recommendation 3:** Alternative procurement strategies require a collaborative mind-set amongst all participants. The Construction Sector Accord is currently developing the Partnership Statement, a tool to guide collaborative and constructive negotiations between client and prospective contractors, reinforcing these attributes. This collaborative mind-set will require a different tolerance level for managing risk from the procuring authorities (e.g. move away from fixed price).

## 2. Background and Purpose

### Background and purpose

The purpose of this paper and the supporting implementation webinars is to provide guidance to Local Government (and other public sector water infrastructure providers) to help these agencies to improve their approach to and execution of water infrastructure procurement to support the New Zealand economic recovery post COVID-19 and address the infrastructure deficit.

### Target audience

- a. Procurement decision makers including:
  - CEOs and CFOs of Local Government
  - General Managers of water services in Local Government
- b. Water Infrastructure Providers
- c. Mayors and Councils

### Approach

This paper will be supported by webinars for the target audience to introduce some of the concepts and the implementation considerations. The Office of the Auditor General, the New Zealand Infrastructure Commission, New Zealand Government Procurement and Property in MBIE, the Construction Sector Accord and Local Government New Zealand were consulted through the development of this paper.

### Overview of the water sector

A wholesale review of the water services sector, known as The Three Waters Review, was prompted by the Havelock North *Campylobacter* outbreak in 2016, when contaminated drinking water caused 5,000 residents to fall ill and the deaths of at least four people. The initial findings raised wider concerns about the effectiveness of the regulatory regime, and the capability and sustainability of the three waters sector. Broadly the key issues and improvement targets identified include the sector's ability to:

- **Water quality, treatment and management:** Meet community needs and regulatory requirements, including issues such as storm and wastewater discharge;
- **Infrastructure (insufficient, inadequate and/ or aging infrastructure):** Replace ageing infrastructure or fund and manage new infrastructure (by Local Authorities but also for rural communities including schools, marae and papakāinga);
- **Sector capacity:** Meet declining rating bases in some areas, high growth in others, and ability to meet high seasonal demand; and
- **Climate change:** Adapt for climate changes including water shortages and adverse natural events (drought, floods etc.).

In January 2020, the Cabinet considered advice on improving New Zealand's three waters service delivery and funding arrangements. The Government confirmed its commitment to partnering with Local Government to consider options for transitioning councils to new service delivery arrangements, allowing for safer, more affordable and reliable three waters services across the country.

### 3. COVID-19 and the Delivery of Water Infrastructure

The construction sector in New Zealand contributes around 7% of the national GDP, employing c. 275,000 New Zealanders. At around \$10 billion per annum, approximately 50% of the construction spend is procured by the public sector. The additional \$3 billion funding to be provided via the Infrastructure Reference Group's 'Shovel Ready' programme will further boost public spending on construction in the Government effort to support the country's economic recovery.

However, New Zealand's construction sector had already been in crisis prior to COVID-19, with the key issues identified by the Construction Sector Accord comprising skills and labour shortages, poor risk allocation, unclear regulations and a lack of a visible, coordinated pipeline of work<sup>1</sup>.

While the effects of COVID-19 on the economy are hard to predict with any certainty, it is undeniable that it will exacerbate the existing issues and likely create new challenges for the delivery of infrastructure in New Zealand, including water infrastructure.

The Local Government sector has already acknowledged that COVID-19 has had an impact on their operations. Undoubtedly, Local Government's finances will be affected due to likely lower revenue from rates and fees coupled with a very challenging environment to increase rates to recover losses. This comes on top of many councils' already stretched balance sheet positions. During the Public Sector Network webinar on Local Government Transformation held in May 2020, 32% of the attendees said that COVID-19 had accelerated their 'transformation' initiatives, while 52% said it had changed the scope. Further, when asked how COVID-19 had changed the agenda, 72% of respondents said efficiency and cost effectiveness had become major factors. However, at the same time funding and the capability of resources have been identified as the key challenges for Local Government in achieving the desired performance levels.

This is particularly concerning given the expected shift in the construction sector dynamic. Over the recent past, the construction sector has witnessed a gradual move away from a Buyers' market into a Sellers' market, in high growth areas such as Auckland, or in Christchurch following the earthquakes. The COVID-19 related disturbance is likely to reinforce this dynamic, which will increase both the risk and cost of capital programme delivery. To identify and address any potential bottlenecks in the market, Local Government must be aware of the following:

- a. **Market capacity:** COVID-19 pandemic has depressed demand across the economy. Ongoing uncertainty means this trend may last in the longer-term. The decrease in private sector demand for construction and related consultancy services is expected to be particularly acute, with redundancies across the supply chain affecting capacity to deliver water projects. Fletcher Building has already announced planned redundancies of around 1,000 FTEs in New Zealand, which will create a ripple effect across the supply chain given that a large amount of Fletcher Building's delivery is outsourced. Without collaboration and phasing of work across Central and Local Government, competing for the same capacity could have detrimental effects.
- b. **International supply chains:** COVID-19 has disturbed global supply chains which came to a halt almost overnight. As a result, the sector's severely constrained ability to source international expertise and workforce (where required) is likely to diminish market capability and further reduce its capacity. Shortage of construction materials and related goods on the back of limited freight services is expected to add to project timelines and costs.
- c. **Risk aversion:** We expect market appetite to absorb risk to decrease significantly throughout the supply chain. This will likely affect suppliers' capacity and appetite to undertake extensive pre-bid work at risk. As a result, inappropriate risk allocation or excessive risk transfer is expected to impact tender participation and/or pricing. Councils will have to carefully consider and adequately manage risk allocation to control associated costs.
- d. **Health and safety:** With social distancing likely to apply in the foreseeable future, health and safety performance will attract greater scrutiny with site performance risk needing to be managed more efficiently. Heightened health and safety concerns may potentially compromise productivity and further add to delivery costs and timescales.
- e. **Uninsurability:** The insurance market is expected to become much tighter, with certain risks potentially becoming uninsurable as the insurance sector reassesses its ability to absorb pandemic related risks. Smaller

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<sup>1</sup> Source: Construction Sector Accord at [constructionaccord.nz/the-accord/](https://www.constructionaccord.nz/the-accord/)

councils with limited or no ability to self-insure will be particularly exposed if premiums become unaffordable, as was the case following the Kaikoura earthquake in 2016.

- f. **Cost escalation:** Project delivery costs have already increased significantly driven by the identified market dynamics. Project contingencies are likely to increase further fuelled by the continued uncertainty over cost inflation and the state of the wider economy. Alternatively, some suppliers may attempt to secure work by lowering prices which could result in an increased risk of insolvencies as they can't absorb the rising cost base.

Local Government needs to be aware of these issues and how they affect delivery confidence, in the short-term as well as over the Long-Term Plan (LTP) period. To respond to these challenges Local Government will need to become more agile in their thinking and enable faster and more effective infrastructure delivery. This will involve working more collaboratively, including with its contractors, providing confidence to the market and supporting the sector through the procurement and delivery process.

This guidance aims to enable Local Government to respond to these challenges.



## 4. Procurement in the Water Sector – A Call to Action

### Why are we focusing on procurement?

The Construction Sector Accord recently provided recommendations on how to rapidly mobilise project delivery across many sectors. This paper focuses on how procurement can support the mobilisation of projects in this new environment. Procurement involves end to end strategic planning, sourcing and managing of contracts. The Government identifies eight steps in the procurement lifecycle consisting of three phases of planning, sourcing and managing as set out in Figure 1 below.

**Figure 1. The Procurement Lifecycle**

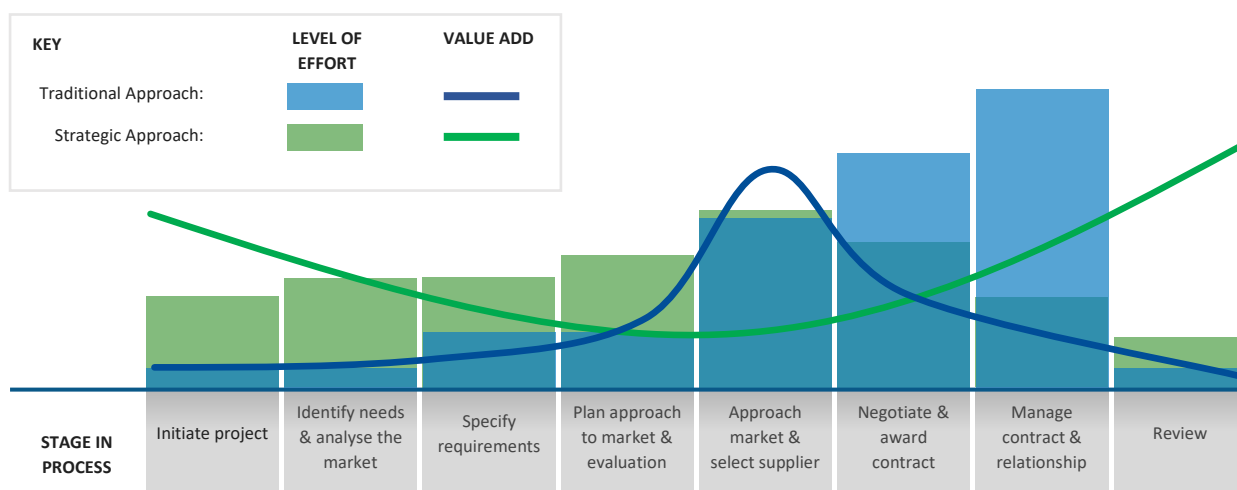


Source: New Zealand Government, *Mastering procurement: A structured approach to strategic procurement*, 2011

A procurement strategy that is well designed and implemented can result in efficient, value for money and timely project or programme delivery, which in turn can significantly help the post COVID-19 economic recovery in the country. In the short-term an improved, streamlined and more efficient procurement of water infrastructure is expected to speed up the delivery of capital renewal and maintenance works, as well as the rollout of new construction project directly contributing to the economic recovery through creation of jobs. In the medium- to long-term, it will support initiatives to improve the delivery of water services through better, higher quality, more efficient infrastructure that delivers quality outcomes and meets the requirements of New Zealanders.

However, efforts often concentrate on the traditional procurement activities (i.e. supplier selection (Step 5 above), negotiations (Step 6), contract award and management (Step 7)), rather than approaching the procurement more strategically (i.e. across the lifecycle). In particular, the procurement of lower value capital renewal projects tends to be process driven focusing on the sourcing of contractors for individual projects. Consequently, the value generated is significantly different with the value increasing when procurement professionals are engaged earlier in the process to influence the development of a procurement strategy (refer to Figure 2 below).

**Figure 2: Traditional vs Strategic Approach to Procurement**



Source: New Zealand Government, *Mastering procurement: A structured approach to strategic procurement*, 2011

## Key challenges in the existing water infrastructure procurement practices

While several initiatives, including the new Government Procurement Rules issued in October 2019, have been implemented over the last few years to improve public sector procurement practices, COVID-19 related market disturbance is creating new challenges that will increase pressure on the procuring agencies. The key challenges in the existing processes that are likely to be exacerbated by the crisis include:

### a. Fragmented planning (related to Step 1 of the Procurement Lifecycle)

There is no national infrastructure strategy in the water sector at present with limited cross-regional and cross-agency collaboration. As a result, most councils tend to focus on projects and delivery of services within their jurisdictions. Additionally, projects are often planned on a stand-alone basis outside of wider programmes of work and without consideration for potential economies of scale and synergies. The implications of these arrangements include:

- Poor pipeline management which inhibits development of national delivery capability, i.e. creates supplier shortages and price increases, or supplier overflows;
- Potentially conflicting water management priorities and work programmes;
- Conflicting priorities for local authority spending, often reprioritised annually;
- Potential duplication of work programmes across councils; and
- Limited communication with the wider sector, so suppliers have limited visibility of the upcoming project pipeline.

### b. Short-term planning horizon (related to Steps 1 and 2)

While Local Government develops 10-year LTPs (and 30-year asset management plans), LTPs are redrafted every three years with little granularity and certainty provided beyond the first year. Therefore, in practice the planning horizon is relatively short-term, which results in ad-hoc pipelines and intermittent use of procurement frameworks across the sector. Consequently, a lack of commitment to capital programmes, whether actual or perceived, may deter the construction sector from making strategic investment decisions resulting in a potential mismatch between demand for and the supply of the construction services in the longer-term.

As identified during our consultations, commitment to project and/ or programme delivery will be critical in the post COVID-19 market, as businesses across the construction supply chain will seek confirmation from the procuring authorities in order to maintain or adjust delivery capacity.

### c. Insufficient 'Market Intelligence' (related to Step 2)

Public organisations often lack an understanding of the nature of the relevant supplier market, participants' operations, required returns, public value concept and capacity to bear risk. As a result, public organisations' historical approach to procurement (delivery model, contract structure and 'lowest cost wins' selection criteria) may adversely affect longer-term goals such as maintaining competitive and efficient supplier markets.

*"From time to time, we receive complaints that some public organisations do not properly understand the supplier market or the effect they are having on it."*

The Office of the Auditor General, *Introducing our work about procurement*, September 2018

Market conditions have deteriorated significantly as a result of COVID-19, which will further fuel the need for the public sector to enhance its understanding of the supplier market and to engage with it on a more collaborative basis.

### d. Defaulting to familiar delivery methods (related to Step 4)

Agencies may tend to default to familiar delivery models, such as Traditional<sup>2</sup> or Direct Managed models, rather than appropriately matching a delivery method and contract structure based on unique project characteristics such as strategic objective, commercial structure, risk profile and scale versus market capacity and capability.

Under normal circumstances, this may result in suboptimal outcomes. Given the current market disruption the appropriateness of such delivery models could be further compromised by a lack of competitive tension, single bidder responses and high prices. The guidance on rapid mobilisation issued by the Construction Sector Accord and the Construction Procurement Playbook currently being developed, seek to help agencies select the most appropriate model depending on the state of the market and the size and complexity of the project.

### e. Focus on lowest price as a Value for Money indicator (related to Steps 3, 4 and 5):

The Local Government Act requires councils to provide services in the most cost-effective way possible. This is often misinterpreted as a competitive process with contract award based on the lowest cost. However, this focus on the lowest priced conforming tender (or high weighting attributed to price) can, and often does, compromise the whole of life value and other outcomes including economic, social, environmental and/ or cultural.

In the current climate, this approach poses a particular risk. As set out above, it is unlikely that the market will be able to respond to competitive tendering given limited capacity, increased risk, inflated costs and medium- to long-term uncertainty.

### f. Inconsistent procurement processes (relating to Step 5)

It is recognised that the approach to procurement process tends to be inconsistent across the sector, which creates potential risks including the risk of decreased process transparency. The issues identified through the consultation process include:

- Involvement of elected members of Local Government in procurement processes, often resulting in promotion of competitive tendering as an approach, a risk that contract awards depart from criteria and add to timescales.
- Tendency to focus on the traditional instead of strategic procurement activities (as presented in Figure 2), which may result in an inappropriate choice of project delivery model, with implications on value for money.
- Tendency to procure stand-alone projects even if it may be more efficient to lump them into programmes of works (e.g. capital renewals).

*"Unfortunately, our Office often sees examples of procurements where the lines between governance and management are blurred. For example, mayors or other elected members might be part of tender evaluation panels. This is not good practice."*

The Office of the Auditor General, *Local government procurement*, May 2020

<sup>2</sup> Under the Traditional model, the design is completed by the procuring agency prior to tender. Under the Direct Managed model, the procuring agency manages all aspects of the process separately appointing and managing suppliers and subcontractors. Delivery models are defined by the Ministry of Business, Innovation and Employment in *Construction Procurement Guidelines*, October 2019.

- Inconsistent evaluation approaches, with more effective evaluation panels scrutinising the suppliers' performance and capacity as the basis of awarding contracts, while others focus on lowest cost.

**g. Excessive risk transfer (related to Steps 2, 4 and 6 above)**

Poor understanding of risk has historically resulted in inadequate risk allocation. Excessive risk transfer onto the private sector is a recognised issue, despite in many instances the public sector being better placed to bear certain risks. Bidders have also often been expected to perform a level of preliminary work at risk as part of the bidding process. This would have created issues throughout the supply chain (e.g. should unreasonably long warranties be demanded) and resulted in low value for money for Local Government as the cost of risk bearing would often be priced into contracts.

The new market conditions mean that fewer suppliers will be willing to bear the level of risk absorbed in the past or will price in significant premiums to protect themselves against these risks. This has been recognised by the Construction Sector Accord, which is currently working on a guidance to support conversations between parties on how risks should be allocated.

**h. Limited feedback loop (relating to Step 8)**

A traditional approach to procurement may result in limited capacity to learn from past experience. To better respond to the new challenges, Local Government will need to embrace a more strategic approach to water infrastructure delivery and improve the review processes.

There has been a lot of use of good practices and processes in the sector, and many councils have already started to adjust to the new market reality. However, given how dramatically the conditions in the market are changing, the focus needs to shift to support the construction sector and improve capital project delivery in order to help the economic recovery.

## 5. Agile Procurement and Supporting Levers

Agile procurement caters to the strategic needs of an organisation, resulting in the selection and implementation of a solution different from that adopted in the past, yet fulfilling the same objectives. Agile procurement is the driver of adaptability, comprising a team that is forward-thinking, collaborative, data-driven and action-oriented. It refers to the method of purchasing outcome-based solutions from potential providers rather than considering a single solution, which results in cost savings for organisations. It takes into consideration the cost pressures and opportunities of the supplier market before collaborating with vendors. This method of procurement tries to align the interests of the organisation with those of the suppliers and values the importance of speed as well as savings.

Agile procurement is characterised by the following key principles:

- **Responding to change rather than following a static plan**
- **Flexibility to tender for outcomes sought rather prescriptive specifications**
- **Promoting innovation**
- **Delivering partnerships and collaboration across the sector**

Crucially, agile procurement is consistent with the Government Procurement Rules, with the New Zealand Government Procurement and Property also currently working on a guidance to support more agile procurement methods (including through the aforementioned Construction Procurement Playbook).

Local Government can capitalise on agile procurement practices by taking a strategic view of their infrastructure portfolio covering both existing capital works including capital renewals and planned maintenance works, and new infrastructure projects, whether financed through their LTPs or the Infrastructure Reference Group's 'Shovel Ready' Programme.

### Potential Agile Procurement Levers

We have identified potential procurement levers for the consideration of water infrastructure delivery decision makers. Importantly, these levers complement each other and required strategic investment planning and management practices to enable the levers to be used. Implementing any of those levers in isolation is unlikely to yield material results. Therefore, it is suggested that a number of levers are considered in combination as well as an improvement of the procurement maturity of the organisations to capitalise on the levers, and to deliver value for money and a better risk profile to deal in these uncertain times.



























## Approach to assessment

We have performed a high-level evaluation of the levers against a common set of criteria. However, this is not a comparative analysis and we do not aim to rank them in any order.

The assessment criteria are:

- **Procurement Maturity:** To implement this lever requires a high level of procurement maturity e.g. strong capability to perform strategic procurement activities to influence the infrastructure project outcomes.
- **Value for Money/ Public value:** If implemented, does the lever help the organisation deliver i). better whole-of-life value, i.e. fit for purpose, high-quality, affordable assets; and ii). better public value through the broader outcomes including social, economic, cultural and/ or environmental?
- **Delivery confidence:** If implemented, does the lever reduce the overall risk profile of the project being delivered?
- **Implementation timeframes:** How quickly can the lever be employed, and the resulting benefits be realised? The implementation timeframes have been defined as:
  - Short-term: 3 – 6 months
  - Medium-term: 6 – 12 months
  - Long-term: over 12 months

**Figure 3: Implementation Assessment**

Lever	Procurement maturity	Value for money	Delivery confidence	Implementation timeframes
1. Long Term Investment Planning				Long term
2. Develop Consolidated Programmes of Work				Medium term
2. Develop Consolidated Programmes of Work				Long term
4. Water Reform Agenda				Long term
5. National Water Delivery Alliance				Medium term
6. Maximise Existing Contractual Arrangements				Short term
7. Alternative Procurement/ Delivery Models				Short term
8. Enhance Procurement Capability				Medium term



## LEVER 1: Long Term Investment Planning

Current planning practice requires Local Government to develop 10-year LTPs. However, little granularity and certainty is provided beyond year one due to a lack of funding certainty. This approach inhibits development of long-term pipelines preventing effective communication with and management of the supplier market. Additionally, projects are often planned on a stand-alone basis outside of the wider programmes of work and without consideration for potential economies of scale, synergies and supply chain capacity.

It is recommended that agencies extend the planning horizon and develop multi-year project pipelines across the sector to develop a sustainable industry. Given the current market conditions, it will be even more important that medium- to long-term pipelines of works promote public sector commitment, market attractiveness, capability investment and innovative practices (such as alternative delivery models identified under Lever 7) for the construction sector to operate more effectively and respond to local and regional demand.

Mitigating the funding uncertainty requires good open communication with the market and the development of a rolling plan where project certainty increases as funding budgets are confirmed.

### Example:

The Watercare Enterprise Model is an example of this approach as they have taken a 10-year view of the capital programme, whilst projects are not defined in the outer years and funding still needs to be contested. This model has promoted collaboration between Watercare and the construction sector, and the performance regime has been built to share savings 40/20/20 across cost management, carbon reduction and improved safety outcomes.

## LEVER 2: Develop Consolidated Programmes of Work

Existing approaches to procurement, e.g. procurement based on a project-by-project basis, often result in lengthy processes with high associated costs (both for the councils and the bidders). Many smaller councils that lack scale and population base struggle with one-off larger investments needed to improve water infrastructure. Bundling projects into programmes of works, or even programmes of works across councils where appropriate, can help the sector deliver better value for money through synergies and economies of scale, and offer a more holistic approach to considering benefits realisation across regions and New Zealand as a whole.

In January 2020, the Cabinet considered advice on improving New Zealand's three waters service delivery and funding arrangements. The Government confirmed its commitment to partnering with Local Government to consider options for transitioning councils to new service delivery arrangements, allowing for safer, more affordable and reliable three waters services across the country. The first step in this partnership is to continue to support councils within regions to investigate opportunities for collaborative approaches to water service delivery.

### Example:

The Waikato Local Authority Shared Services (Waikato LASS) is an example of cross-agency collaboration, based on shared ownership. Waikato LASS is a company owned by twelve councils – Waikato Regional, Hamilton City, Hauraki District, Matamata Piako District, Otorohanga District, Rotorua District, South Waikato District, Taupo District, Thames Coromandel District, Waikato District, Waipa District and Waitomo District. Established in 2005, the aim of Waikato LASS is, among other things, to promote sharing of services to increase efficiency and reduce costs through leveraging economies of scale. The Waikato LASS is currently in the process of developing a programme of procurement comprising previously planned works budgeted for in their LTPs and projects that may be granted funding under the 'Shovel Ready' initiative. The aim is to identify projects that can potentially be bundled into programmes and to establish the most suitable models to deliver them.<sup>3</sup>

## LEVER 3: Efficient Resource and Capacity Management

The benefits of joined up pipeline management are widely recognised. However, there is no national Three Waters Strategy at present with limited cross-regional, cross-agency collaboration. Initiatives to develop better tools to manage market resources and capacity more efficiently exist at various levels of government, creating opportunities for better management of projects. Local Government needs to be involved in these developments.

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<sup>3</sup> Source: Construction Sector Accord, *Rapid mobilisation models for the construction sector to support post COVID-19 recovery*, May 2020

To that end, the current focus on projects and delivery of services within individual councils' remits should be enhanced with collaboration within and across regions, with Levers 1 and 2 being the starting points. Further actions include improving Local Government's understanding of the market through active engagement with suppliers, e.g. proactive workshopping and leveraging industry briefings before detailed procurement planning. Ultimately, an integrated pipeline of capital works is required to assist the sector in delivering and building the capacity.

**Example:**

One of the key roles of the New Zealand Infrastructure Commission is to publish a pipeline of credible public sector capital projects to provide greater visibility to the contractor and consultant market. The pipeline was first published in May 2019 focusing on state departments' infrastructure projects. The second edition, published in November 2019, included a number of regional projects for the Manawatu-Whanganui region. The New Zealand Infrastructure Commission has been collecting lower level pipeline information over the last few months from a number of agencies including Local Government. The intention is to keep expanding the pipeline. However, further work and collaboration is required for the New Zealand Infrastructure Commission's pipeline to become a single comprehensive and trusted source of information for the market. It is recommended that Councils proactively share their water infrastructure plans with the New Zealand Infrastructure Commission to leverage and maximise this existing initiative.

#### **LEVER 4. Water Reform Agenda**

Prior to COVID-19, New Zealand Government were investigating a potential reform of the water sector through introducing the Water Regulator and consolidating services providers to address long standing water infrastructure network problems. If this agenda was to be progressed then this transition programme would take a few years to stage, but it could help to prioritise the infrastructure upgrade programme, develop consolidated procurement and delivery services and potentially provide wider social, economic, cultural and environmental outcomes to support New Zealand's recovery.

COVID-19 could be an accelerator to the Water reform agenda as councils will face challenges to fund the capital programmes and deliver them without either Central Government funding or alternative sources of funding and financing.

**Example:**

In February 2019, five Hawke's Bay councils (Napier City Council, Hastings District Council, Central Hawke's Bay District Council, Wairoa District Council and Hawke's Bay Regional Council) initiated a joint review of the region's three waters delivery arrangements triggered by The Waters Review. The councils have since secured \$1.55m of Central Government funding to support their investigation. The review aims to evaluate the region's capacity, capability, capital assets and operational challenges, and to identify opportunities for collaboration and greater coordination in how the three waters are delivered across the whole region. While the completion of the review is not expected until the second half of 2021, it is anticipated to potentially serve as a prototype to identify if there are any efficiencies to be obtained at a national level.

#### **LEVER 5. National Water Delivery Alliance**

Previously when major disruptions have occurred to the construction market and economy such as the Christchurch earthquake or Cyclone Yasi in Queensland, the response was to turn to the alliance procurement and delivery model (refer to Lever 7 below for details). Alliance contracting is highly collaborative and can accelerate the speed of the infrastructure programme delivery. The typical criteria for adopting an alliance model (whether pure, hybrid or competitive) are:

- Scope uncertainty, which makes it difficult to achieve sensible fixed price procurement;
- Political sensitivity – owner involvement, senior non-owner support e.g. Central Government funding;
- Resourcing constraints:
  - Owner (Local Authorities)
  - Market (Construction sector)
- General complexity (stakeholders, project certainty, programme, mix of disciplines).

**Example:**

The Stronger Christchurch infrastructure Rebuild Team (SCIRT) Alliance was established to manage the significant scale and complexity of the horizontal infrastructure rebuild following the Christchurch earthquakes.



Approximately 900km of water infrastructure was replaced or repaired using this model. The key objectives were to collaboratively plan, design, execute and manage the reconstruction programme. While a number of lessons have been derived from the programme, the Alliance built on existing relationships between all the participants e.g. constructors, council and Central Government.

## **LEVER 6: Maximise Existing Contractual Arrangements**

Councils should aim to leverage the experience of other councils and the procurement, contractual arrangements that have already been tried and tested elsewhere in the water sector in New Zealand. Some of the measures include:

- Panels of suppliers are suitable when multiple projects are delivered over a long time period (e.g. capital renewals). Suppliers are pre-approved based on their capability to deliver works and agreement to the terms and conditions for supply. Existing panels can be leveraged within or across regions, or councils may consider jointly establishing supplier panels reducing time, cost and administrative burden of individual councils, as well as potentially expanding the supplier base.
- Adhere to recognised standard forms of contract for selected delivery models limiting the use of special conditions to maintain consistency of approach and transparency in contracting arrangements across suppliers.
- Overcome a bias toward the lowest-price evaluation model and place greater emphasis on broader outcomes i.e. social, economic, cultural, environmental<sup>4</sup>, to drive better public value. In the current economic climate, priority outcome one 'Increasing access for New Zealand businesses', as identified by the Government and incorporated into the Government Procurement Rules, is of particular importance. A consistent approach to tendering and clear communication with the market are the first steps to encouraging smaller, local contractors to participate in public works tenders including large programmes of works as subcontractors in the supply chain.

If security packages are used, councils could consider reviewing the level of security packages currently required with a view of supporting liquidity in the construction sector, expected to be particularly acute in the post COVID-19 environment. This could potentially be a temporary measure coupled with a more collaborative approach to managing potential cost issues when they arise. The new Government Procurement Rules (fourth edition published in October 2019) is a framework to improve the delivery of wider public benefits and outcomes through more efficient procurement and therefore can be replicated across Councils.

### **Example:**

Following signing up to the Construction Sector Accord, Auckland Council has embarked on a review of special conditions in its major works contracts. The review concluded that special conditions mostly related to risk transfer significantly altering the standard form. To improve its construction contracts' procurement practice Auckland Council is looking to revert to the standard. This clearer and more consistent approach to contracting is expected to improve market participation.

## **LEVER 7: Alternative Procurement & Delivery Models**

It is not uncommon for the procuring agencies to default to 'transactional' delivery models (such as Traditional or Direct models). However, the choice of the delivery model should correspond to the particular characteristics of a given project (i.e. scale, complexity and risk). There are a number of alternative delivery models that are based on collaboration or partnerships that may be more adequate for certain projects.

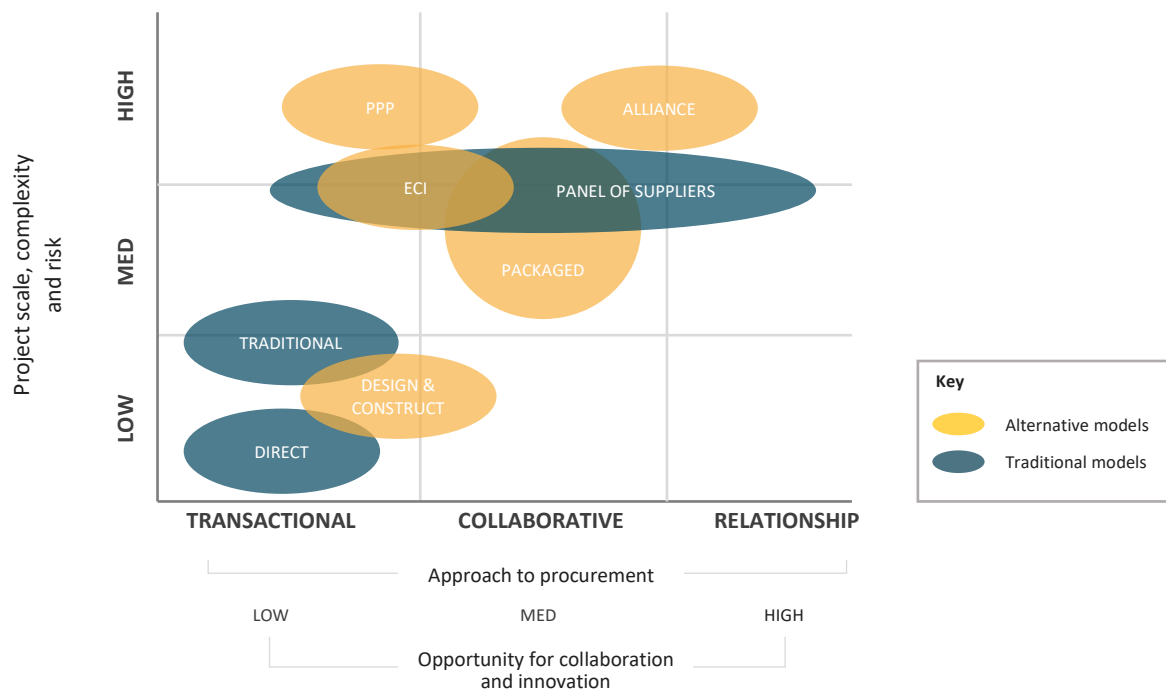
The procurement strategy (i.e. the choice of the most appropriate delivery model and approach to market) should be developed during the planning phase of the procurement lifecycle. The key variable is the level of collaboration between the various parties during the design process.

The new Construction Procurement Guidelines set out the process and varying models with an aim to help the procuring agencies improve the quality and consistency of their construction procurement practices.

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<sup>4</sup> The four well-beings, social, economic, environmental and cultural, were reinstated into the Local Government Act 2002 through an amendment in 2019.

**Figure 4: Procurement Delivery Models**



Source: Ministry of Business, Innovation and Employment, *Construction Procurement Guidelines*, October 2019

Agencies should consider the most optimal delivery model. Alternative delivery models include:

- **Design & Construct (D&C):** The main contractor takes on the responsibility for both the design and construction according to the functional and technical specification. D&C provide better certainty in cost, and cost-benefits, optimises value for money (as aspects of buildability will be key factors in design decisions). The expertise of the supply chain can also be leveraged to develop innovative design solutions that maximise project benefits.
- **Package Based (PB):** Package-based delivery models allow an earlier on-site start and enable the tender process and construction to overlap with design. They have been developed to provide faster project delivery times while still allowing the client to retain control over the design, and therefore quality. Management methods break down project into small packages that can be tendered as and when the design for each package is complete.
- **Early Contractor Involvement (ECI):** The model leverages private sector expertise by incorporating early advice from a contractor into the design optimisation and buildability. It is more suited to large, complex or high-risk projects because it affords an integrated team time to gain an early understanding of requirements, enabling robust risk management, innovation and public value.
- **Alliance (project or programme alliances):** The model is a relationship-style arrangement, that brings together the procuring agency and one or more parties to work together to deliver the project or programme of works, sharing project risks and rewards. Collaborative procurement methods should be used for highly-complex or large infrastructure projects that would be difficult to effectively scope, price and deliver under a more traditional delivery model.
- **Public Private Partnerships (PPP):** a model based on long-term contracts for the delivery services, where the provision of the service requires the construction of a facility or asset, or the enhancement of an existing facility. Under a PPP, the private sector partner finances, designs and builds the facility, and operates it for a fixed contract term (typically around 25 years), at the end of which it transfers control of the asset to the public sector. A key objective of the PPP approach is the drive to optimise whole-of-life outcomes by encouraging innovation from the private sector.

## LEVER 8: Enhance Procurement Capability

Implementation of the levers requires an appropriate level of procurement skills, knowledge and competence. For example, Lever 3 (Efficient Resource and Capacity Management), Lever 6 (Maximise Existing Contractual Arrangements) and Lever 7 (Alternative Procurement/ Delivery Models) will require experienced judgement to inform the choice of the delivery model such that it suits both a project's unique characteristics and market capability. Our discussions indicate that investment is required to develop the Local Government procurement network to support this.

This will require enhancement of procurement capabilities including market intelligence, understanding of alternative delivery models and the associated assessment frameworks. With the new focus on broader outcomes, there will be greater emphasis on building the capability of procurement professionals to meet the challenge. This will be delivered through online and in-person learning opportunities and guidance, all of which is available to Local Government procurers. However, more work will need to be done.

*"Although cost savings are important, the public organisations we spoke to consider that NZGP has focused too much on making savings and not enough on improving public sector procurement capability. This is needed to improve the quality of procurement decision-making, promote more mature and streamlined procurement, and promote innovation among public organisations."*

*The Office of the Auditor General, Using "functional leadership" to improve government procurement, November 2019*

While some councils may already have the required level of capability, others are likely to lack this expertise for reasons no other than limited capacity. A more collaborative approach across councils to resourcing and knowledge sharing, advocated by the Office of the Auditor General, is likely to improve the procurement outcomes across the country. Initiatives could include:

- Cross sharing of procurement capability and capacity across Local Government;
- Leveraging existing tools such as the Procurement Capability Index (PCI) and, in collaboration with and New Zealand Government Procurement and Property, implementing a national procurement capability framework and accreditation model for organisations and individuals, as used in New South Wales;
- The use of specialist advice and leveraging central government entities, such as the New Zealand Infrastructure Commission and New Zealand Government Procurement and Property, to support development of the procurement capability framework; and
- Providing training, additional support and coaching to accelerate the adoption of the procurement capability framework for councils that need it.

### Example:

Many councils already work together. While more formal structures, e.g. through shared services companies such the Waikato LASS are still relatively rare in New Zealand, less formal settings include forums such as the Local Government Strategic Procurement Group, which provides a platform for the procurement staff from various councils to exchange knowledge and ideas, and to share best practice.

## 6. Implementation Considerations

Local Government is facing uncertain times, which led to the establishment of the COVID-19 Local Government Response Unit. Some of the challenges Local Government will face in implementing the strategic procurement levers are identified below.

- **Funding constraints:** Perhaps the single most important issue is the long-term funding, required to support Local Government's long-term commitment to project delivery. As budgets are appropriated annually, the uncertainty over funding available may prevent efficient long-term planning. This will be particularly acute in the current environment as more direct economic needs will compete for the same pool of funding.
- **Competing agendas:** Implementation of a large number of levers relies heavily on genuine partnership between councils and other parties. While there have been a number of instances of successful regional collaboration (e.g. Waikato LASS, Wellington Water, Watercare), councils' agendas and interests may compete making consensus building across multiple councils challenging.
- **Behavioural resistance:** Constraints are often self-imposed and underlined by cultural inertia, inherited custom and practice. Ultimately though, people are at the core of any change and resistance may also be partly driven by uncertainty over the implications of the new norm. Councils will need to ensure that the benefits of any changes are well understood by the staff implementing them to ensure internal buy-in and support.
- **Capacity and information gaps:** While circumstances vary by council, the overall procurement capacity in Local Government is limited. However, there are potential tools and training that councils can develop centrally to support enhancement of their capability. This could be facilitated and supported by the Local Government Strategic Procurement Group, the New Zealand Infrastructure Commission and the New Zealand Government Procurement and Property in MBIE.

Addressing these challenges will require strong leadership and collective effort. However, to Local Government's advantage the New Zealand procurement rules are flexible with no legal barriers to levers' implementation. In addition, the latest guidance from all the agencies supports initiatives based on collaboration, innovation and agile measures.

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