

# Procurement and contract strategies

## Achieving Excellence in Construction Procurement Guide



01

02

03

04

05

06

07

08

09

10

11



# Contents

<b>The Achieving Excellence Procurement Guides</b>	<b>3</b>
<b>Introduction</b>	<b>4</b>
<b>Principles</b>	<b>4</b>
<b>Process</b>	<b>7</b>
<b>Annexes</b>	<b>20</b>
<b>Further information</b>	<b>22</b>

## **NAO endorsement**

The NAO recognise that proactive client leadership and robust project management are prerequisites to the successful delivery of construction procurement.

They consider that procurement of construction should be on the basis of whole-life value for money and endorse the use of the good practice promoted by this suite of guides. They may investigate whether this good practice is applied in practice in any future examination.

## **Acknowledgements**

This guide has been published after extensive consultation within government and valuable contributions from leading individuals and organisations across the construction industry.

OGC would like to thank all who have contributed.

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# The Achieving Excellence Procurement Guides

The *Achieving Excellence* suite of procurement guides replaces the *Construction Procurement Guidance Notes* series.

The new series reflects developments in construction procurement over recent years and builds on government clients' experience of implementing the *Achieving Excellence in Construction* initiative.

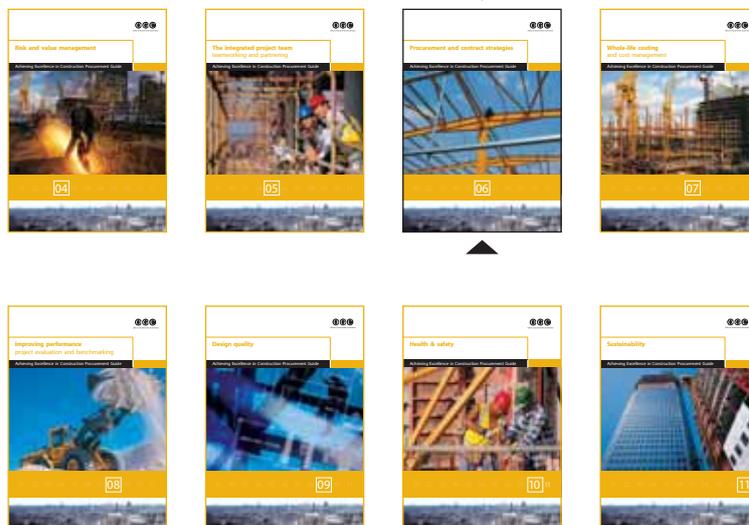
## High level guides



## Core guides



## Supporting guides



The primary consideration in the procurement of construction projects is the need to obtain best value for money in the whole life of the service or facility. The design and operation of the facility should maximise the delivery of effective public services; this is most likely to be achieved through integration of the design, construction, operation and ongoing maintenance.

### Introduction

This guide explains how to determine appropriate procurement routes that will deliver best value for money. Design, construction, operation and maintenance should not be considered in isolation from each other. The recommended procurement routes allow designers, constructors and specialist suppliers to work together in an integrated team.

### Principles

Procurement decisions about construction projects should always be on the basis of value for money over the life of the facility and not on the initial capital cost alone. OGC's Best Practice briefing: *Value for money evaluations in complex procurements* explains how to take account of all the factors when making an investment decision; all central government departments have to demonstrate their compliance with this best practice.

### Definitions

**Value for money:** this is the optimum combination of whole-life costs and quality to meet the user requirement.

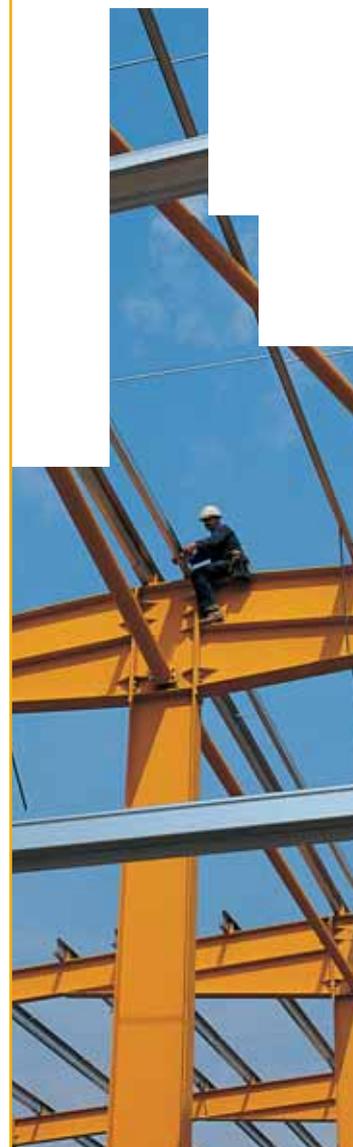
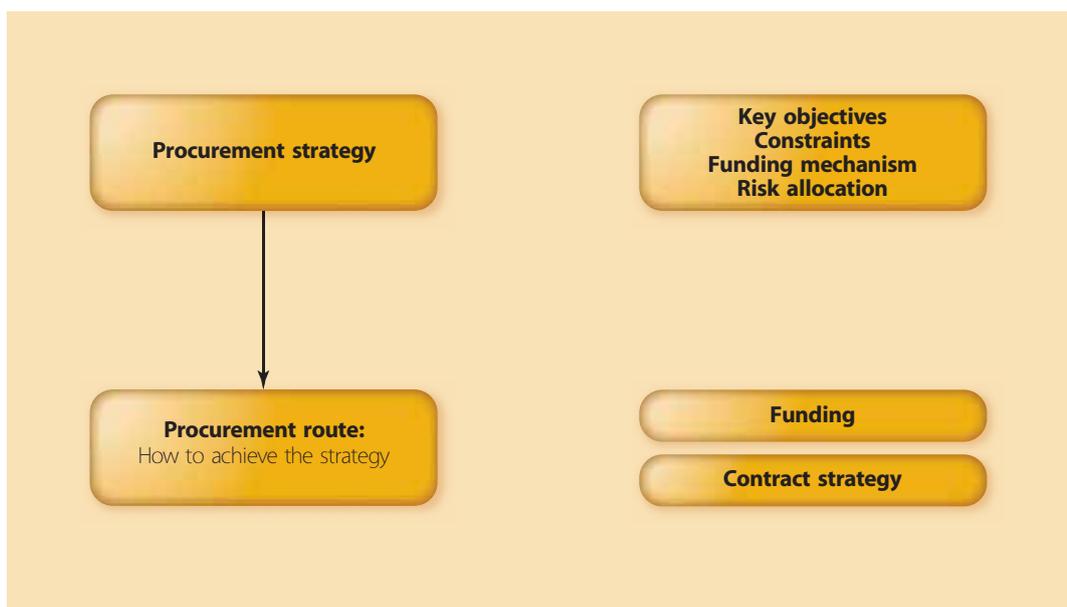
**Procurement strategy:** the procurement strategy identifies the best way of achieving the objectives of the project and value for money, taking account of the risks and constraints, leading to decisions about the funding mechanism and asset ownership for the project. The aim of a procurement strategy is to achieve the optimum balance of risk, control and funding for a particular project.

**Procurement route:** the procurement route delivers the procurement strategy. It includes the contract strategy that will best meet the client's needs. An integrated procurement route ensures that design, construction, operation and maintenance are considered as a whole; it also ensures that the delivery team work together as an integrated project team.

**Contract strategy:** the contract strategy determines the level of integration of design, construction and ongoing maintenance for a given project, and should support the main project objectives in terms of risk allocation, delivery, incentivisation and so on. There are a number of different contract strategies; the recommended strategies to meet *Achieving Excellence* principles of integration are outlined in this guide.

Figure 1 shows the relationship between the procurement strategy, procurement route and contract strategy. The procurement strategy determines the most appropriate procurement route, including the contract strategy, to fit the project objectives and current circumstances. For every construction project the client should consider the design, construction, operation and maintenance of the facility as a whole, together with how the project will be funded. An integrated procurement route should be adopted to deliver the project, where all of these aspects have been considered together.

### 1 Procurement strategy and procurement route



### Preferred integrated procurement routes

Since April 2000, government policy has been that projects should be procured by one of the three recommended procurement routes (PFI, Prime Contracting or Design & Build). Before concluding the preferred integrated procurement route, Departments should consider the HMT report *PFI: Meeting the Investment Challenge*. This suggests that construction projects whose capital cost does not exceed £20m are not likely to achieve value for money under the PFI route. Traditional procurement routes should only be used if they demonstrably add value in comparison to the three recommended routes. Assessing value for money is a central process in procurement. For PFI projects the Government will institute a new assessment of the potential value for money of procurement options when overall investment decisions are made; reform the Public Sector Comparator (PSC) (alternative route may still be chosen); and set up a final assessment of competitive interest in a project.

The new *Achieving Excellence* targets, agreed by Ministers in December 2002, require projects to demonstrate a significant improvement in performance against quality, cost and time targets. In order to achieve these, it is essential that all procuring bodies move towards proper integration of the design, construction and operation functions. This will require a move to fully integrated teams, early supply team involvement, incentivised payment mechanisms, continuous improvement processes and joint commitment to achieving best whole-life value. These requirements are applicable whichever of the three preferred procurement routes is selected. Framework arrangements may also add value.

### 2 OGC definitions of preferred integrated procurement routes

<b>PFI</b>	Where the public sector contracts to purchase quality services, with defined outputs from the private sector on long-term basis, and including maintaining or constructing the necessary infrastructure so as to take advantage of private management skills incentivised by having private finance at risk.
<b>Prime Contracting</b>	Using a single contractor to act as the sole point of responsibility to a public sector client for the management and delivery of a construction project on time, within budget (defined over the lifetime of the project) and fit for the purpose for which it was intended, including demonstrating during the initial period of operation that operating cost and performance parameters can be met in accordance with a pre-agreed cost model.
<b>Design &amp; Build</b>	Using a single contractor to act as the sole point of responsibility to a public sector client for the design, management and delivery of a construction project on time, within budget (taking account of whole-life costs) and in accordance with a pre-defined output specification using reasonable skill and care.

An integrated project team should be appointed to carry out the project. However, the procurement strategy may indicate that separate contracts for part of the project are appropriate to meet specific objectives (for example, the NHS has developed standard designs to be incorporated in their facilities, which are constructed to the standard specification by different suppliers). The important point to note is that the project is considered as a whole, regardless of whether it is delivered through a single contract or through several related contracts.

Traditional contract strategies, where the design and construction are provided separately, should only be used where it can be clearly demonstrated that this approach will provide better value for money than the preferred integrated procurement routes highlighted above. In a traditional contract, the design is undertaken by a team separately appointed by the client, with construction by a contractor competitively appointed on the basis of a detailed specification prepared by the client's consultants.

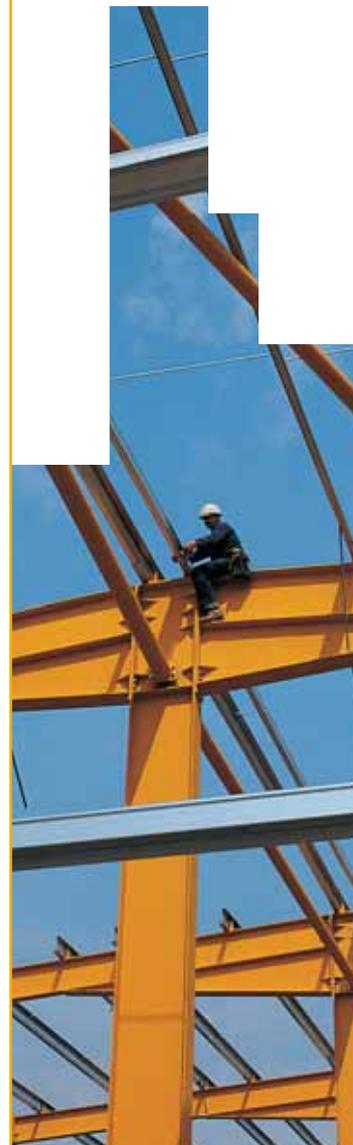
What clients need to be able to do:

- be able to define clearly what they want
- be aware of the market and negotiate deals that are justified on whole-life value
- know how the industry works, collecting market intelligence and regularly carrying out market research
- know the major players, establish who regularly works well with whom and get to know the specialist suppliers
- develop more effective arrangements to build up and share knowledge about the performance of particular suppliers and the construction market generally, so that decisions about the appointment of suppliers are better informed.

## Process

This section describes the practicalities of the procurement process. It explains the steps to take in determining the procurement route and outlines the main points to consider before procuring the construction project.

Figure 3 summarises the procurement process and shows OGC's Gateway review stages (described in more detail below). For details of the procurement process in general terms, see the introduction to procurement on the OGC Website at [www.ogc.gov.uk/introduction\\_to\\_procurement.asp](http://www.ogc.gov.uk/introduction_to_procurement.asp)



## 06 Procurement and contract strategies

The factors that influence the procurement strategy should be considered:

- the project objectives – for example, to provide office space for x people to deliver a specific service
- constraints – such as budget and funding; the timeframe in which the facility is to be delivered; exit strategy
- cultural factors – such as considerations about the workspace environment that will best support the way people work
- risks – such as late completion of the facility; innovative use of materials
- the client's capabilities to manage a project of this type
- the length of operational service required from the facility.

### 3 Procurement process

Procurement Stage	Gateway review	Key procurement tasks up to each Gate
Establish business need	Gate 0: Strategic assessment	Identify high-level options for meeting the business need
Develop business case	Gate 1: Business justification	Produce high-level business case (Strategic Outline Case) and detailed options appraisal
Develop procurement strategy	Gate 2: Procurement strategy	Produce Outline Business Case; determine procurement route (including contract strategy); produce output-based specification and criteria for selection and award; OJEU advertisement if required
Competitive procurement	Gate 3: Investment decision	Competitive tendering (where there is no existing arrangement with a supply team) leading to contract award for integrated supply team; Full business Case
Award and implement contract; outline design	Decision point 1: Outline design	Following approval of outline design, proceed to detailed design
Detailed design	Decision point 2: Detailed design	Following approval of detailed design, proceed to construction
Take delivery of facility; settle final accounts/start unitary payments (PFI)	Gate 4: Readiness for service	Commissioning of facility; handover to contract management where applicable
Manage contract for services, where applicable	Gate 5: Benefits evaluation	Post implementation review, to confirm achievement of business benefits as the justification for investment in the facility

Some compromises may have to be made to arrive at the optimum way forward, in order to achieve the optimum balance of risk, benefit and funding for a particular project.

### Case Study

#### The Environment Agency

The Environment Agency's procurement strategy for engineering works has the following aims:

- to deliver best value for money to the Agency
- to be at the leading edge of technology, innovation and business best practice
- to champion environmental best practice.

The Agency has increased the value of its projects by combining similar projects or work within a region. It has also reduced the number of consultancy suppliers from forty-six to four.

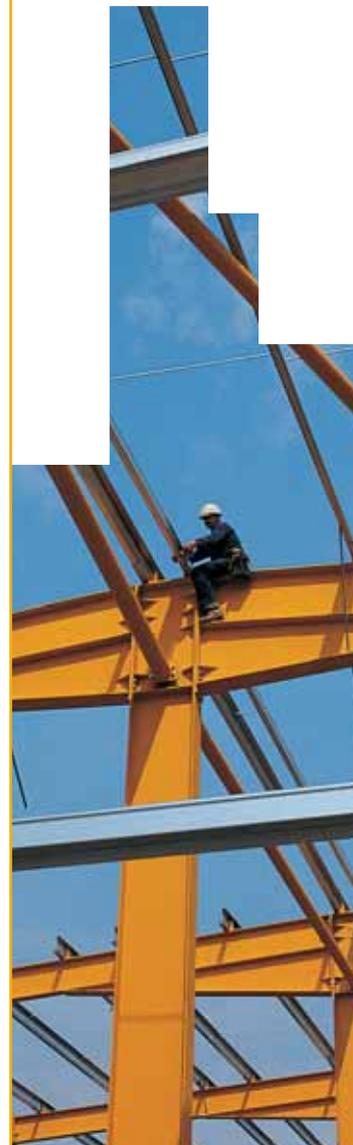
It has a national team responsible for the procurement and project management of capital projects to deliver new ways of working and to provide consistency in processes and relationships with suppliers.

Suppliers should be better informed about the Agency's needs. Projects will be of higher value and for longer periods. This will allow suppliers to learn from one part of the work to the next and to agree targets for improvements to both cost and quality. Suppliers should make higher margins and cover both fair profits and overheads. They will have greater certainty of work, enabling them to invest some of the profits in development work.

Fewer suppliers will be used, who will be able to develop a better understanding of the Agency's needs and to respond with more innovative solutions to those needs. Suppliers will receive a more consistent approach from a better informed and trained client. Suppliers' profitability on Agency work is now also linked to the achievement of the Agency's target.

#### Level of risk transfer and funding arrangement

Decide on the optimum allocation of risk associated with the project and how the project will be procured, in order to achieve the optimum allocation of project risks. These need to be identified and considered with the most suitable procurement strategy. At one extreme, there is more scope to allocate risk to a provider of a managed service with the Private Finance Initiative. At the other extreme, there is more scope to allocate risk to the client who maintains ownership of a capital asset and upfront capital payment for construction (Crown build); see Figure 4. The Government's approach to risk in PFI projects does not seek to transfer risks to the private sector as an end in itself. Where risks are transferred, it is to create the correct disciplines and incentives on the private sector to achieve a better outcome. The options depend on the project objectives.

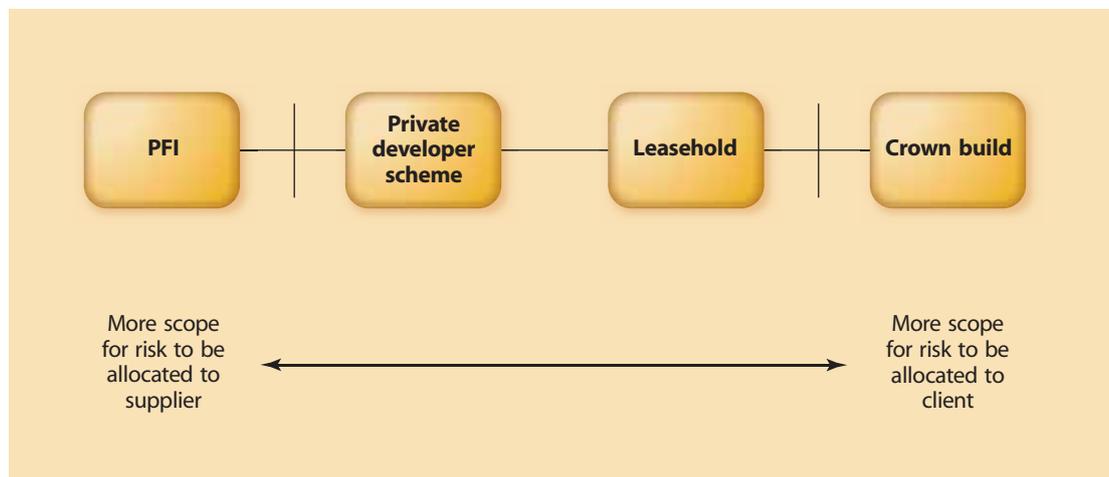


## 06 Procurement and contract strategies

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For example, there may be a requirement to accommodate staff delivering a particular service over a long period of time where there are unlikely to be fluctuating demands for office space, where a managed service would meet the business need. Alternatively, there might be a short-term requirement to accommodate the same staff, where the business need is known to change in the near future – in this case, the need could be met by leasing or refurbishing for a short period. In addition, funding may or may not be available for a construction project. Contract strategies will also encompass a range of degree of risk transfer as shown in Figure 5.

### 4 Level of risk transfer and funding arrangement

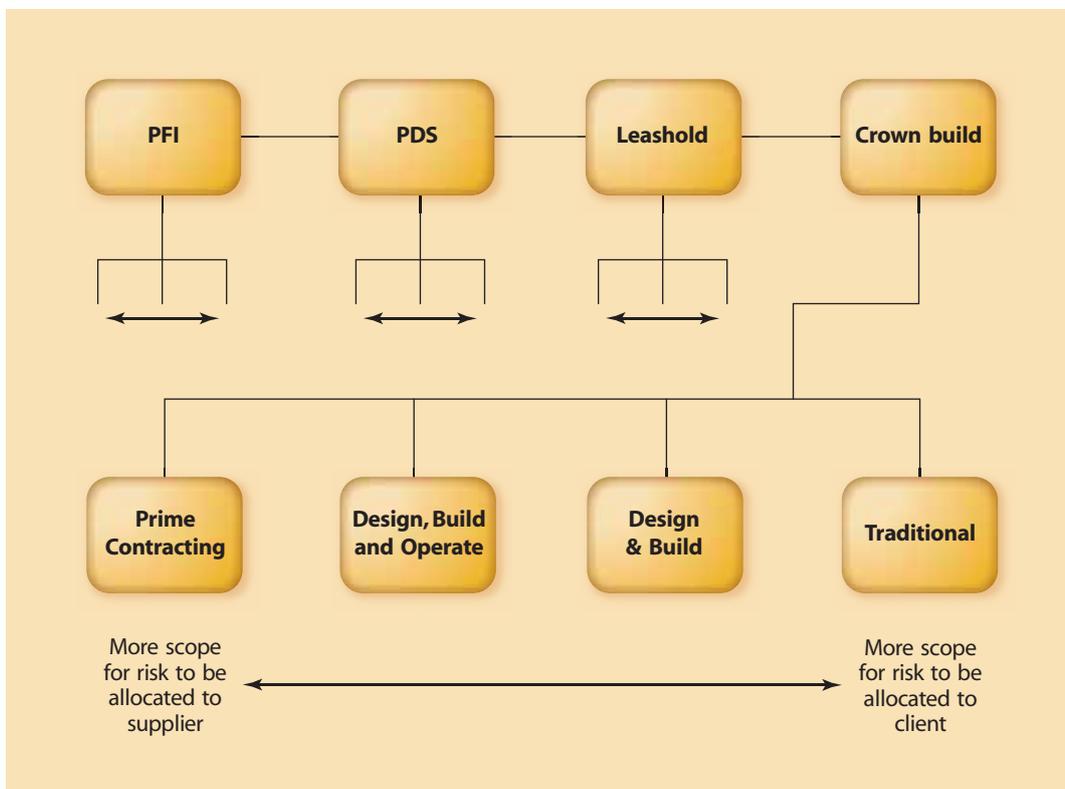


Funding options include:

- **PFI:** construction projects are undertaken by the private sector, who are incentivised by having private finance at risk, and have asset ownership for the duration of the contract; ongoing maintenance and operation are also provided by the private sector in PFI arrangements, with government (revenue budget) or users charged for the service provision. PFI is explored in detail in *PFI: Meeting the investment challenge*.
- **Private Developer Scheme (PDS):** typically this may be a construction project undertaken and funded by a developer for the provision of workspace for government occupation, with government recharged on a rental basis as a function of the capital cost of the works and land. PDS is a preletting/purchase of space that would not otherwise be constructed in the absence of a forward commitment to lease or purchase. Funding is usually from the developer and the rental is a function of the total development costs. EU Procurement Rules may apply to such procurements, depending on a combination of the value of the works and the extent of client specification. Clients should seek advice from their organisation's procurement experts in respect of their specific circumstances, especially if they are unclear as to whether or not the EU rules apply

- **Leasehold:** in this arrangement the client occupies a facility under a lease but does not own it. Construction projects might include refurbishment or fit-out, funded directly by the client via capital expenditure budget
- **Crown build:** these are new build or refurbishment construction projects funded directly by the client via capital expenditure budget, with asset ownership (freehold) remaining with the client.

### 5 Level of risk transfer and contract strategy



#### Determining the contract strategy

This section describes the contract strategies that could be used to achieve the objectives of the procurement strategy; see also Annex A for a summary table.



## 06 Procurement and contract strategies

**Private Finance Initiative (PFI):** only recommended for projects whose capital cost is likely to exceed £20m, are created for the provision of services and not for the exclusive provision of capital assets such as buildings. For this reason it is preferable to investigate PFI as soon as possible after a user need has been identified rather than leaving it until a conventional construction project has been selected as the solution. It is possible that a PFI project may result in a solution (provision of services to meet the user need) that does not require a construction project. Additional guidance is available from the HM Treasury PFI Unit.

**Design & Build:** in a Design & Build contract, the integrated project team is responsible for both the design and construction of the facility. The supply team is likely to deliver the greatest performance benefits to the client through innovation, standardisation and integrated supply chains, where appropriate output specifications are used. These specifications focus on what the completed facility enables the client to do (for example, to provide a standard office environment for fifty staff). They do not specify the detail (number of doors and windows etc) except where there are specialised requirements, because the supplier will be better placed to decide on how the requirement will be met.

Where an output specification is not well developed, there is a risk that the quality, design and performance of the completed facility may be compromised. Careful attention to the output specification is essential to achieve the required outcome.

There may be some circumstances where the Design & Build procurement option should be extended to cover maintenance and also possibly operation of the facility for a substantial period. By including the maintenance and operation requirements within a design and construction contract, the supplier has increased incentive for adopting innovative solutions that provide greater value for money when considering whole-life costs. Departmental Private Finance Units and HM Treasury's Private Finance Unit should be able to provide advice on how best to consider maintenance and operation.

**Prime Contracting:** Prime Contracting requires there to be a single point of responsibility (the Prime Contractor) between the client and the supply team. The Prime Contractor needs to be an organisation with the ability to bring together all of the parties (the supply team) necessary to meet the client's requirements effectively. There is nothing to prevent a designer, facilities manager, financier or any other organisation from acting as the Prime Contractor, providing they have suitable ability and experience. Prime Contracting must demonstrate during the initial occupation period that operating cost and performance parameters can be met. It usually includes such features as pain/gain share (where the Prime Contractor as well as the client gains financially by reducing the project costs), target cost pricing (where prices are agreed on the basis of a reasonable profit for the supply team and value for money to the client) and open book accounting (where costs are made transparent to the client).

As part of the selection process, clients should request details of the parties likely to be in the supply team. A significant number of the other organisations that make up the supply team should be made known and taken into account during the technical capacity assessment. At selection interviews, the client should expect to meet representatives from all the main companies in the supply team.

Questions to ask about the contract strategy:

- What resources and expertise does the client have?
- What influence/control does the client need to exert over the design?
- Who is best able to carry out the design?
- What influences/controls does the client wish to exert over the management of:
  - planning (project, construction)?
  - interfaces (project, end-users)?
  - risk?
  - design?
  - construction?
- What can the market provide and what framework agreements are already in place?

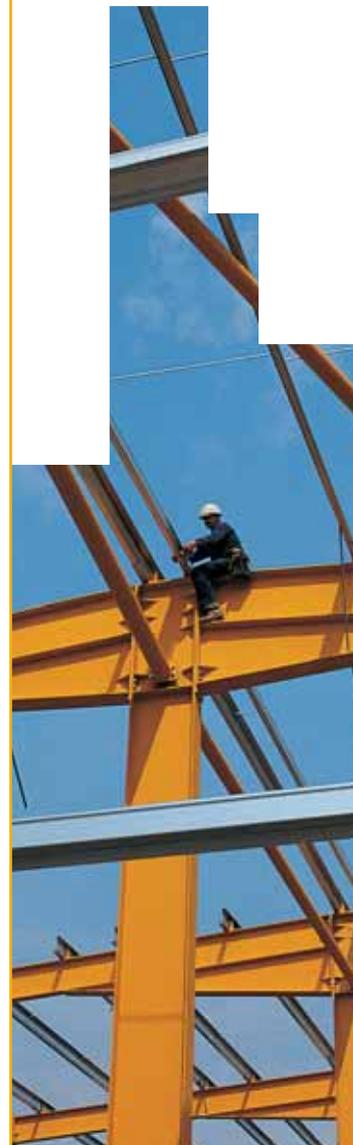
#### Checklist: procurement route and contract

Assessing the procurement route:

- is this the right procurement route for the project, backed up with a contract in which roles and responsibilities are clearly defined and risks are appropriately allocated?
- are choices about allocating risk and control tailored to the circumstances of the project and reflected in the procurement strategy?
- has the most appropriate integrated procurement route been chosen – PFI, Design & Build or Prime Contracting?

Assessing the contract:

- have improvement targets and measurement arrangements been agreed with the integrated project team and quantified?
- have incentives been included in the contract to encourage the integrated project team to perform well and achieve the client's objectives?
- have the required benefits been quantified before incentive payments will be paid?



### Framework agreements

Framework agreements with a single supplier or a number of suppliers can result in significant savings to both parties. There is no requirement for constant re-tendering at call-off stage as long as the contract conditions are unchanged for each project; there may also be substantial gains from continuous improvement. Where contract terms are changed, mini-competitions within the framework will need to take place. Clients may have more than one framework supplier in place for different requirements. However, the resource implications for the client should be borne in mind when deciding whether to appoint more than one framework supplier under a single framework agreement.

Framework agreements may be used for Prime Contracting and Design & Build procurement routes. They can also be appropriate for maintenance requirements. Clients with small or occasional projects should consider collaborating with others in a similar situation to share a framework agreement (or use those managed by OGCBuying.solutions).

Each framework agreement must be advertised and competed for in accordance with EU Procurement Rules. It should be noted that there is no commitment under a framework agreement for either party to undertake any business until the first contract is 'called off'.

The expectation is that savings in cost and time will come from the following:

- no requirement for rebidding of each individual project
- continuous improvement by transferring learning from one project to another
- improved working relationships
- continuous workflow
- speed of procurement.

#### Checklist: frameworks

- Forecasting: each year the client organisation should provide the framework suppliers with the best information available on anticipated demand.
- Key information: clients provide key information about their projects to all framework suppliers at the start of each project.
- Contractual commitment: framework agreements are not usually contracts in their own right as defined in EU Procurement Directives, but agreements to do business under specific terms. Within the framework a contract (call-off) is let for each project, but this is no more complex than placing an order because the price structure and conditions of contract are fixed. The specification must also be fixed (see below).
- Standardised output specification: where appropriate, the client should seek opportunities to standardise specifications to improve predictability, cost and maintainability.

### Decide on the form of contract

Consider the **form of contract** to deliver the requirement. Forms of contract should aim to improve the quality and cost-effective delivery of clients' projects through:

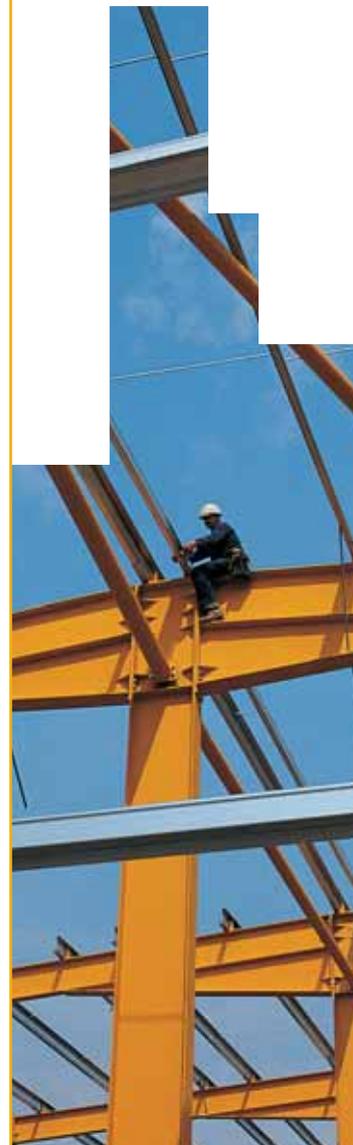
- incentivising the whole supply team to perform better
- requiring clients to consider the individual risks involved with any construction project carefully and allocate each risk to the party who is best able to manage it
- setting up partnering arrangements between clients and suppliers who are committed to continuous improvement and who have a commitment to integrated project teams and working with established supply chains.

The contract requirement sets out what the integrated project team is required to do under the contract. The specification forms a key part of the requirement (together with the project brief) and should be output-based. The requirement should include milestones and targets that are SMART – specific, measurable, agreed, realistic and time-based.

Contractual relationships are described by the contract documents, although it is recognised that the way the contracting parties approach the contractual relationship is of primary importance. The 'words-of-the-contract' describing the risk allocation, how problems will be overcome and how the parties will work together to strongly influence the development of the relationship and ultimately the success of the project. Whether specially written or using standard forms, contracts can approach the contractual relationship in different ways but the *Achieving Excellence in Construction* initiative focuses on working together in a particular way – the contract documents should facilitate this.

Within the construction industry a number of standard forms of contract are used and these forms are being developed and adapted in response to the cultural changes arising from new ways of working, including the *Achieving Excellence in Construction* initiative. In addition, new forms of contract are being developed and introduced by different industry groups. These industry-standard forms have different attributes and standards of compliance with the *Achieving Excellence* agenda. The form of contract used should be selected according to the objectives of the project and aiming to satisfy the *Achieving Excellence* agenda. Various model forms exist, each with different attributes and compliance with *Achieving Excellence*.

The use of standard forms of contract helps to reduce both tendering and contract administration costs. Bespoke or amended standard forms require clients and tenderers to seek additional and frequently costly legal advice and this increases the risk of disputes arising from unfamiliar terms. To avoid unnecessary additional costs, such bespoke forms should only be used where they are considered essential rather than simply desirable and demonstrably provide greater value for money. Any amendments should only be made after receiving technical and legal advice. Infrequent clients are not advised to make such changes at all.



'There is scope for benefits in terms of quality, faster construction times and financial savings through contractors and their clients working more closely together in longer-term relationships (partnering). Subject to appropriate safeguards, such productive relationships deserve to be promoted in public sector construction. These safeguards include the appointment of partners through competition; periodically re-tendering; agreeing clear, measurable targets for continuous improvements in quality, delivery time and cost reductions; establishing payment arrangements to give contractors incentives to be innovative and cost-effective; and securing reasonable access to contractors' financial records and cost information to check that agreed improvements in efficiency and performance are being achieved.'

Public Accounts Committee Report: Improving Construction Performance, December 2001

### Sources of information about potential suppliers

Constructionline is an information source designed to streamline pre-qualification procedures, increase quality and reduce costs by supplying the construction industry and clients with a single, national qualification system. Constructionline assesses suppliers and consultants according to strict technical and financial criteria so as to allow them to pre-qualify for tender lists for public and private sector contracts. Constructionline offers a central source of information in order to cut through the current duplication of effort by both suppliers and clients. (See [www.constructionline.co.uk](http://www.constructionline.co.uk) for more information.)

### Points to consider before starting the procurement

The Gateway review stages (in Figure 3) are points along the procurement process beyond which the project should not proceed without specific management and funding activities having been completed. At each decision point, the investment decision maker should evaluate the business case and investment proposals and, if justified, give approval for the project to proceed.

### The Gateway process

The Gateway process must be undertaken for all procurement projects in central civil government. Depending on the level of risk for the project, Gateway reviews may be carried out by independent internal or external review teams. It is important to note that for construction projects there are two additional major decision points between Gates 3 and 4. The first is approval for the outline design, the second is the point at which the detailed design is approved before the construction activity can begin. There may also be a requirement for more than one Gate 3, when the investment decision for the project is made. If there is a second investment decision (such as for two-stage Design & Build) there may be a need for a Gate 3 for the contract award and a subsequent Gate 3 to confirm the investment decision based on the construction price.

Gateway reviews should also be undertaken for projects using an existing IST arrangement.

Independent client advice may be required in the early stages of a project. Where the client organisation is small and/or an occasional construction client, it is strongly recommended that independent client advice is sought early, to ensure that the project is appropriately scoped and will meet the business need.

### EU Procurement Rules

Depending on the scale of the project, EU rules may apply. The estimated value of the contract will dictate whether a procurement will fall within the EU rules (remember to apply, where relevant, the aggregation rules which require the value of individual contracts to be aggregated in particular circumstances specified in the regulations). Advice on the preparation of estimates is given in *AE7:Whole-life costing and cost management*.

Where an estimate falls below the relevant threshold, although the appointment process will not fall within the regulations, it must still comply with the EU Treaty obligations. However, where in the light of that estimate the regulations are deemed not to apply but the actual cost exceeds the threshold, the department may have to justify the basis of its original estimate. Where the estimated contract value is close to the threshold, the client organisation should apply the regulations.

Note that where the EU rules apply, consultancy contracts are covered by the Services Regulations (SI 1993/3228) and the appointment of suppliers for works contracts by the Works Regulations (SI 1991/2680). Clients should seek specialist advice from their departmental procurement unit. For further information on EU Procurement Rules, see OGC EU Procurement Guidance - Introduction to EU Procurement Rules at [www.ogc.gov.uk/documents/Introduction\\_to\\_EU\\_Procurement\\_Rules.pdf](http://www.ogc.gov.uk/documents/Introduction_to_EU_Procurement_Rules.pdf)

### Defining the requirement

Specifications describing the requirement are developed before Gate 2. Irrespective of the form of procurement adopted, all specifications should be output (outcome) based unless there are exceptional reasons to the contrary. Output specifications are not prescriptive but must accurately describe the outcome required. Unnecessary detail will tend to inhibit innovation and result in extra costs. Performance measures should be used as part of the specification to define how the project requirements will be measured for quality and performance. (See *AE3:Project procurement lifecycle* and *AE9:Design quality*.)

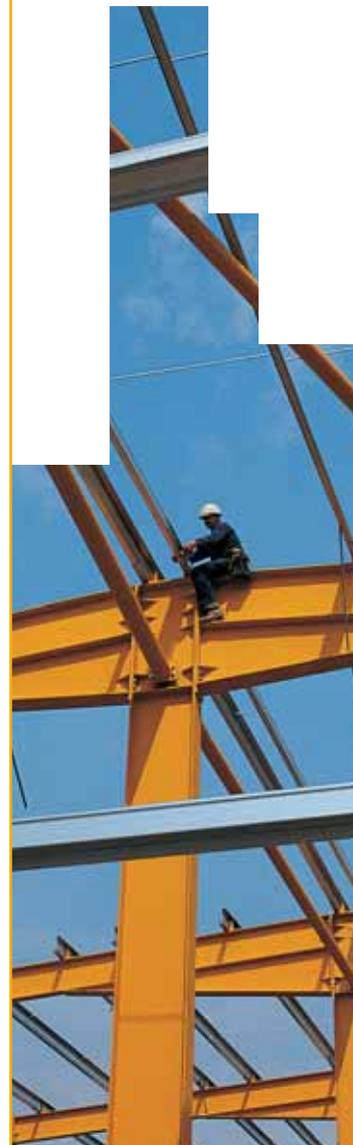
### Defining selection and award criteria

Criteria for selecting the integrated supply team and evaluating bids should be defined before Gate 2. Selection criteria should include:

- previous performance on teamworking as part of an integrated supply team
- previous performance of supply chain management, including current teamworking and partnering arrangements between members of the integrated supply team
- evidence of the skills/abilities of individual members of the supply team
- project-specific supply chain management proposals.

Key award criteria to be used in the bid evaluation process should include:

- project-specific proposals for teamworking and partnering between the integrated supply team and the client organisation and throughout the supply chain
- bidders' risk identification (including health and safety aspects), evaluation and proposals for risk management during the project.



## 06 Procurement and contract strategies

Under the EU rules, each of the award criteria must relate directly to the economic advantage that the contracting authority expects to gain as a result of placing the specific contract.

Value management workshop techniques involving key stakeholders provide a useful means of establishing the selection and award criteria and their respective weightings. Value management can also be used to evaluate how well each bid meets the criteria. (See *AE4: Risk and value management*.)

For every contract or partnering agreement, consideration should be given to how incentive arrangements could deliver greater value for money and benefit to the supply team, especially where they are proposing innovation as a contribution to value engineering.

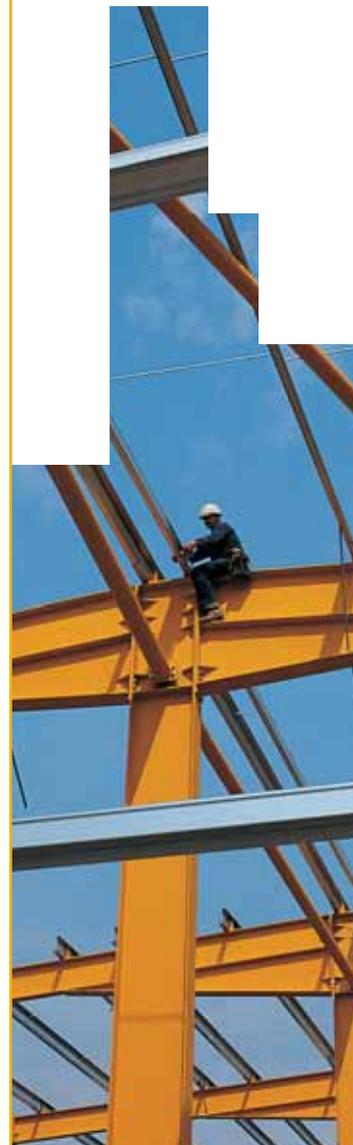
Appropriate payment mechanisms and incentives can be built into the contract (see Figure 6). Performance targets on which incentives are based must be measurable. Clients will need to weigh up the benefits of proposed improvements, exercising appropriate judgement before agreeing to them.

### 6 Examples of payment mechanisms

Payment mechanism	Advantages	Points to watch
<b>Fixed price (Design &amp; Build)</b> The integrated supply team is appointed to design and construct the facility and is paid a combined fixed price for both components of the project. The risk of the design not working is transferred to the integrated supply team.	The client has certainty as to the final price of the facility.  Buildability may be considered during design.	Transferring all risk to the integrated supply team may not be cost-effective, as the client still carries the risk to their business of the new facility not being available when required.  Changes to requirements can be very expensive and destroy price certainty.  The output specification needs to be very clear and avoid weaknesses or ambiguities, to prevent a reduction in the finished quality of the facility. There may be a break point between stages to review affordability and continued value for money.

Payment mechanism	Advantages	Points to watch
<p><b>Target price</b></p> <p>Client and supply team together to develop a target price for the facility. Often there can be some sharing of efficiency improvements as well as risk.</p>	<p>The client has certainty over price and the integrated project team has an incentive to make cost savings for the benefit of both the supply team and the client.</p>	<p>The target and arrangements for sharing efficiency and cost savings need to be established carefully to ensure value for money.</p>
<p><b>Payment on the basis of outcomes</b></p> <p>The integrated supply team is paid on the basis of achieved outputs such as delivery on time and achieving agreed standards of reliability, capacity and safety.</p>	<p>Incentivises the integrated supply team to consider the long-term needs of end-users and the overall performance of the completed building.</p>	<p>This form of contract can be complex, and it may take time to reach agreement with the integrated supply team on the outputs to be achieved and how achievement will be measured.</p>
<p><b>Target price with agreed profit and overhead</b></p> <p>A target price is developed during the design stage.</p>	<p>The price has two elements – cost, which all those involved in the integrated project team seek to reduce, and profit, which increases as a result of greater efficiency and innovation.</p> <p>Pain/gain share lump sum profit and overhead as opposed to percentage.</p>	<p>All members of the integrated supply team need to know their individual costs, which they are incentivised to keep to a minimum.</p> <p>The target price has to be set at a level that gives sufficient incentive and value for money for the type and complexity of facility being constructed.</p>

(Based on NAO source)



### **Annex A: Evaluation of procurement routes**

Figure 7 provides an evaluation template to evaluate how well each procurement route is likely to deliver value for money in terms of whole-life costs. PFI is not listed as an option as it would be chosen as a procurement strategy; however, it may be useful to add PFI for comparison with the main procurement routes.

The evaluation criteria used in the mechanism must be chosen so that they relate specifically to aspects that will determine value in whole-life cost terms. The relative importance of each evaluation criterion is established by giving it a percentage weighting so that all the weightings add up to 100%.

The mechanism provides a means of helping construction procurement teams reach a decision about the procurement route likely to deliver greatest value for money but it does not replace the need for an expert to advise on the decision on the basis of all information available.

There is clearly scope to distort the outcome by manipulating the evaluation criteria, weightings and even the mechanism itself. Whatever mechanism is developed, it must help to identify the procurement route likely to deliver greatest value for money. If a second construction procurement expert independently was to develop a second mechanism and evaluation criteria, the same conclusions about the procurement route likely to deliver greatest value for money should be drawn from it as the first mechanism. Sensitivity analysis may help to highlight the adequacies of a mechanism.



### Further information

- *Guide to the appointment of consultants and contractors (GACC)*, OGC's Property and Construction Directorate
- *Selecting consultants for the team: balancing quality and price*, Construction Industry Board (ISBN 0 7277 2543 2)
- *Code of practice for the selection of main contractors*, Construction Industry Board (ISBN 0 7277 2618 8)
- *Briefing the team*, Construction Industry Board (ISBN 0 7277 2540 8)
- *Value by competition: a guide to the competitive procurement of consultancy services for construction*, CIRIA special publication 117 (ISBN 0 86017 414 X)
- *PFI: meeting the investment challenge*, [www.hm-treasury.gov.uk/media/648B2/PFI\\_604.pdf](http://www.hm-treasury.gov.uk/media/648B2/PFI_604.pdf)





CP00066/01/07



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#### **Press enquiries**

**T:** 020 7271 1318

**F:** 020 7271 1345

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