SPCB REPORT TO PARLIAMENT: HOLYROOD PROJECT JUNE 2001

Summary

1. Holyrood Progress Group newsletters have kept Members up to date with progress on the project in recent months. It is now appropriate for the Corporate Body to report formally to Parliament on the current situation in relation to cost and programme.

2. The contents of this paper can be summarised as follows:

- the project is still scheduled for completion of construction at the end of December 2002 and full occupation by May 2003;
- 82% of the total cost plan value of the project has now either been let or is going through the tender process;
- the vast majority of packages have been let at a price broadly in line with the cost plan estimate;
- some packages will cost more than expected and an uncompetitive marketplace means few contracts have been finalised significantly <u>below</u> expectations;
- opportunities for cost savings have been carefully considered and taken wherever possible. They have been unanimously rejected where the integrity or quality of the architecture would be compromised;
- <u>in the absence of any future inflation and risk related costs</u>, the current projected outturn cost of the project would be £198m;
- construction industry inflation is estimated to be likely to add at least a further £10.4m to future packages;
- as with any construction project, there are still things which could go wrong – the so-called risks. While everyone will be working hard to minimise these, recent analysis suggests that if they <u>were</u> to come to fruition, a reasonable estimate of the impact on costs would be £14.2m design risk and £12.1m construction risk;
- given these uncertainties, it would be misleading to suggest a new ‘capped’ figure to Parliament;
- all risks will be managed rigorously and the SPCB will report through HPG to the Finance Committee on any variations from the expected budget so that both Parliament and Executive can be informed at the earliest date about the final outturn costs as these become more certain.

Tender results and construction costs

3. We are now at a point where £51m (at 1998 prices) has been committed in contracts and a further £38m is currently moving through the tender process. In total that represents 82% of the cost plan value of the project. As the most recent edition of the HPG newsletter shows, in general terms the majority of works packages have been committed at a price in line with the cost plan estimate plus the indexed allowance for inflation. The principal exception to this was the East Frame (the structure of the debating chamber and committee towers). Being a structural package it offered little in the way of savings and since it is such a fundamental part of the structure HPG saw no alternative to proceeding with the current design and treating the overspend as a call on the contingency fund.

4. However, while most tenders have been broadly in line with cost estimates there have not been many instances of contracts being finalised significantly below expectations which might have helped to off-set higher tenders and absorb some of the effects of inflation. Some packages have seen six-figure savings and we are also anticipating good news on the mechanical and electrical packages. However, the majority of credit accrued is not of this order nor is it associated with the biggest contracts.

5. The reasons for this un-competitive environment are hard to pin down. There is some evidence to suggest that periods of negative publicity surrounding the project deterred some contractors. It is also possible that the undoubted complexity of the design was less appealing to some at a time when there is a glut of similar but simpler projects nearby. We have written testimony from Bovis to the effect that many local contractors with whom they would have expected to trade may have shied away from becoming involved with the project. They also report that discussions with the local Employment Service indicated that no surplus construction resource currently exists on their database. They conclude that the level of media interest surrounding the project coupled with the fact that the local and national market is buoyant in more traditional forms of construction has resulted in far less interest than expected.

Savings exercise

6. In order to address these pressures, and in addition to the routine work undertaken by the design team to contain costs, the Progress Group commissioned a series of cost-saving exercises on a site-wide basis.

7. As a result of these, £2.5m worth of savings were instructed, including simplification of windows and doors in the MSP block; reduction in flooring specification throughout the complex and a number of other technical details. These savings were realised without compromising the integrity of the design itself. In some instances opportunities were taken to revisit the balance between the quality of finish in the private and public areas respectively, a redistribution of resources which we believe to be in the interests of the perception of the building as a whole.

8. In addition to this, the most recent site-wide savings exercise proposed five main areas in which significant savings might be made. These were: replacement of the

pre-cast concrete vaults in the main public entrance foyer with an in-situ rendered solution; the introduction of a column to prop the cantilever over the formal entrance; the omission of all remaining light grey concrete in the public areas and replacement with standard coloured concrete; the reduction of the overall quantity of granite as a component of the external cladding design; the replacement of all Kemnay granite with Portuguese granite.

9. After extensive consideration of these proposals and lengthy deliberations, the Progress Group and the SPCB were unanimously of the view that these design changes should not be accepted. Each one would either seriously compromise the integrity and quality of the design or be unacceptable to the planning authority, Historic Scotland and the Royal Fine Art Commission.

Inflation

10. As was reported by the HPG in January, the inflationary pressures on this project are considerable. The budget of £195m was based on a construction cost of £108m which was at 1998 prices, i.e. exclusive of construction industry inflation which runs at a level higher than the general rate of inflation. It is measured using a set of recognised indices called the Building Cost Information Service (BCIS) indices. These are national and do not reflect accurately any particular ‘hotspots’ such as that characterising the Edinburgh area just now.

11. Technically inflation is outwith the control of the project. As the estimation of inflation is a retrospective science and its full impact cannot be assessed until completion, it is impossible to tell what the final position on this will be. The indices do give us a rough guesstimate and the degree of certainty grows with every passing quarter and as more contracts are let.

12. To date, we have committed £59.5m in cash terms, of which the BCIS indices suggest that £8.3m (incl. VAT and fees) is attributable to construction industry inflation. Using current predictions, inflation will add upwards of 16% to the cost plan value of the packages remaining to be tendered. On the current construction cost estimate, that would give a figure in the region of £10.4m (incl. VAT and fees). The total amount which is currently estimated to be likely to be attributable to inflation, including the associated VAT and fees is £18.7m.

The risk analysis process and categorisation of risk

13. As noted by the AGS in his report on the project, risk analysis is a key component of any construction undertaking. While it is recognised good practice in public sector projects not to include an identified allowance within a construction management contract to cover all the possible eventualities which might come to pass, Project Management has been conducting routine analyses of risk ever since the outset of this project.

14. The most recent major risk review has just been reported to us. A ‘risk review’ is a standard technique of project management involving representatives of the design team, construction management, cost consultancy and project team in making a

considered assessment of all the eventualities which might conceivably befall the project prior to completion.

15. There are 3 basic categories of risk, (none of which are new to the project, since under a Construction Management contract the client keeps and manages risk):

- Force majeure: (outwith the control of the project and including things such as insolvency of trade contractors and extreme weather conditions). While some actions can be taken by management to mitigate these, they cannot be prevented from happening. If they were to arise they would have to be dealt with but no realistic assessment of the financial impact can be made.

- Client body decision: these are risks which are within the control of the client and which the HPG will endeavour to overcome through swift decision making and minimal if any change to the briefed requirements.

- Design and construction risks: this is the key category of risk with which this paper is concerned. Within this category itself there are two distinct types of risk.

Design Risk

16. The first is design risk. This can be summarised as being the risk that trade packages cannot be bought for the price allocated against them in the cost plan, for whatever reason. We have already realised some £4.5m of design risk in relation to the East Frame package (see para 3). There are other packages currently going through the tender process where it is thought that it is unlikely that those particular items will come in exactly on cost plan, (which is not to say that within the global sum they may not be offset by more favourable tender results elsewhere on the project). At present, the nominal amount of risk set against these items is valued at £10.5m, (£14.2m including fees and VAT). Obviously, as more tenders are let these risks will either crystallise into money spent or else disappear completely. In the meantime the Progress Group have instructed the design team to devote all their combined efforts to ensuring that they simplify and economise on every one of these packages to minimise any overspend. We have also been reassured that the remaining trade packages are far more straightforward and therefore less likely to have any risk sums allocated against them. There will be considerably more certainty about the outstanding design risks by mid autumn by which time over £100m worth of construction costs will have been committed.

Construction Risk

17. The second type of risk in this category is construction risk. Bringing their experience and professional judgement to bear, the team make an educated guess about what might happen over the remainder of the project; judge the impact it would have if it did happen; estimate the total potential cost of it happening; set that against the likelihood of it happening and thereby arrive at a nominal amount to which the client is judged to be exposed, (in £s and weeks). An example is as follows: there is a risk that Bovis might not be able to work freely on site due to constraints imposed by complaints made by neighbours about noise. If this were to happen, the impact would be large; the total cost to the client could be £2m. Yet it has been

assessed that there is only a small likelihood of this happening, (the probability is 10%), and therefore the nominal amount to which the Parliament might be exposed appears in the risk register as £200,000.

18. In this latter category there are both those risks which can be predicted (however small the likelihood of their happening) and those which simply cannot. It is for the latter category – which includes the stresses imposed by the very high level of activity on site which we will be seeing over the coming 12 months – that the construction contingency sum is traditionally set aside. Bovis have suggested that in their experience a reasonable sum to set against the complete unknowns remaining in this project could be somewhere in the region of £9m (£12.1m incl.VAT and fees); they also acknowledge that it could turn out to be less and it could be more.

19. All our professional advisers remind us that risk analysis is by no means an exact science. The examples given above illustrate the extent to which it is by its very nature based upon educated guesses made at one point in time and the picture is constantly moving. We also believe that all of these construction risks are capable of being managed rigorously. We have instructed the team to bring their professional skills to bear in making sure that many of these risks never actually cost us anything either in terms of money or time, or at the very least to minimise the impact they make on budget and programme.

Costs

Table 1: Summary of estimated costs as at 28 March 2000 (SP paper 99)	
Site, demolition and archaeology	5.0
Fit out	19.5
Fees and site organisation	26.3
VAT	25.4
Construction contingency	10.8
Construction estimate (at 1998 cost plan prices)	108.0
TOTAL	**£195.0**

Table 2: Summary of current position as known at 7 June 2001	
Site, demolition and archaeology	5.0
Fit out	19.5
Fees and site organisation	31.2
Original cost plan value of packages let to date (at 1998 prices)	51.2
Additional premium paid for inflation to date	8.3
VAT on relevant items above	15.8
Subtotal (committed to date)	**131.0**
Original cost plan value of packages still to be let (at 1998 prices)	56.8
VAT on the above	9.9
TOTAL	**£197.7**

20. Table 2 sets out the extent of those things we can be certain about at present. It does not take account of the things we cannot know for definite, i.e. the future rate of inflation and the possible materialisation of future risks.

21. However, it is clear that the effects of inflation on contract prices to date have already pushed the likely expenditure over and above the figure named in the Parliamentary resolution of 5 April 2000. While the wording of that resolution was not specific about whether it intended £195m to be read in cash or in real terms, the Progress Group rightly took the view that we could not presume that real terms were intended. It is therefore appropriate that we should seek Parliament's view at this juncture on how to proceed.

22. After careful reflection, the Progress Group and the SPCB have concluded that it would be in no-one's interests to suggest a new 'capped' figure to Parliament. Not only would it be misleading to suggest that we can have a high degree of certainty about the outturn costs, it would also show our hand both to potential tenderers and to the Design Team just at the very point when we are endeavouring to keep the latter buckled down to working within budget.

23. However, we are keenly aware of the implications for Scottish Executive forward budget planning of any increase in the SPCB capital requirement. With this in mind, we intend to invite Parliament to note the current position and the relevant variables and to authorise us to proceed on this basis, reporting regularly to the Finance Committee on progress against budget in order to inform their consideration of the annual budget process. Specific authority to spend would of course be sought from Parliament via the annual Budget Act.

24. To this end, the following motion has been lodged today:

That the Parliament notes that £60m of construction costs for the new Parliament building have been committed to date and that a further £57m (at 1998 prices) remains to be let; notes that the current projected outturn cost of the project, in the absence of any future inflation and risk related costs would be £198m; notes the fact that building industry inflation is currently estimated to be adding 16% to the cost plan prices, that the local Edinburgh rate of construction inflation will exceed this level and that the total impact of inflation cannot be fully assessed until completion of the project; further notes that there are additional and not fully quantifiable risks to which the project may be exposed between now and occupation; directs the Scottish Parliamentary Corporate Body, through the Holyrood Progress Group, to work with the Design and Project Teams to complete the project without compromising quality, managing risks rigorously; and requires the Progress Group to report to the Corporate Body and the Finance Committee no less than quarterly on the progress of the project in respect of inflation and materialisation of risk.

Scottish Parliamentary Corporate Body
June 2001