Insight

Taking the heat out of procurement

By John Robbins, Managing Director

Construction clients often overlook the rising risk of cost escalations as booming markets such as New York begins to overheat – even though tactical tools exist to cool hotspots.

A complex array of factors has been overheating the construction market in markets such as New York and Seattle to melting point as demand outpaces supply and pushes prices to record highs.

Yet despite the disruptive symptoms, from labour shortages to the rocketing costs of commoditised building materials and contractor cost mark-ups, many commercial property owners and developers seeking to build in this white hot landscape often remain far too cool about the risks.

While they may understand the risks of cost escalations in such a market, organisational factors encourage many to turn a blind eye or compromise – and pay a premium as a result.

The threat of cost escalations is real – and really painful if contractors and materials suppliers are left to dictate the terms – but what property clients often overlook in their zeal to deliver projects ever faster is that there are tried and tested tactics to avoid overspending or reduce the risk it poses and “cool” market hotspots.

In overheating cities like New York, construction markets have echoes of previous bubbles, the difference today is how common it is to assume technological advances mean a skyscraper can be put up overnight or interior fit-out projects delivered at double the speed. If property owners and developers are in too much of a hurry, they run expensive risks that could disrupt a build, forcing them to reduce project scope or – in the worst case – cancel it.

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Property developers and owners may make choices about the design of a building or space that, when the procurement cycle begins, are simply unaffordable, thereby facing harder selections down the line about what to give up.

However, a smart procurement strategy aimed at minimising risk and incorporated early in a project’s life can avoid these dilemmas, deliver huge savings on certain products, materials and services, and so ensure that property tenants, owners and developers can mitigate risky disruption.
Cooling the hotspots

There are a number of practical tactics that can be adopted to reduce risks and avoid paying over-inflated prices are:

**Good governance:** Changing and volatile markets make it imperative to take a strategic approach to procurement planned well in advance, especially where there is a shift away from traditional buying. Having good governance in place will address how best to control and manage project costs, schedule as well as stakeholder engagement. Ultimately, this reduces uncertainty by ensuring that the client, consultants and contractors all live by that same playbook.

**Direct manufacturer engagement:** On large construction projects, costs can be pushed up by having to procure manufactured products through intermediaries. Dealing directly with a manufacturer for certain goods and bulk materials, thereby “cutting out the middle man”, reduces handling charges and simplifies the coordination of purchases. For example on fit-out projects, furniture manufacturers tend to sell through dealers, raising costs. On a project of scale, however, they will readily deal directly with a customer and agree a fixed price or discounting structure for products, resulting in savings and cast iron delivery commitments. This is in both their interests: they benefit from guarantees of work and generally longer term commitments that ease cash flow headaches.

**Contingency control:** Contingency funding is greatly misunderstood and it is not uncommon to hear design firms, architects, engineers and even contractors suggest that clients will always figure out ways to pay. Tackling such a mindset requires a cultural shift, and one of the only ways to nurture virtuous behaviour is to establish watertight rules around contingency drawdown. This is achieved through the governance: transparency and project controls that clearly define the overall budget and, if there is a contingency, what it is for and how it will be controlled by the client.

**Exclusive relationship-building:** Clients undertaking multiple projects often align themselves with contractors whose work they know, building long-term relationships founded on convenience and goodwill. But such relationships can be a hostage to fortune, locking in opportunities for some contractors to push up margins or hold fast on change orders.

It can help to have an outside party, such as an independent project management expert who understands and can navigate the current market, capitalise on the benefits of these relationships, such as the trust that may exist between client and contractor – but also monitor them. Ultimately, this is a question of fairness: a project manager may need to remind contractors who have benefited from years of work that such a relationship is founded upon fair dealing, and that this is a two-way street, as well as negotiate on the client’s behalf to achieve market cost norms.

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**Site logistics controls:** It is surprising how often efficient controls over site logistics facilities such as hoists, cranes, and staging are overlooked on largescale projects with multiple tenants or buildings in built-up cities. The result can be too many contractors competing for the same resources at the same time, or crane operators unable to progress while other work is underway. Centralising how site logistics are developed, bought and managed can provide real cost efficiencies compared to buying them in separately through individual trade contractors. Funnelling on-site demand for these resources through one central point avoids waste.
**Smart timing**: Timing is an essential element of major projects in a cyclical fast-changing market that changes rapidly such as New York, particularly for long-term builds dependent on commodities such as steel, plasterboard and copper. In early 2015, for example, there was a spike in the price of steel – disadvantaging those who needed it at that time. Sensible timing in procurement offers opportunities to hedge and lock in pricing for these commodities, generating significant savings when compared to “just-in-time” buying. It is dependent upon watching market and labour requirements closely which, in turn, rewards expertise.

**Smart savings**

Turner & Townsend has worked with a renowned technology and media institution in the US undertaking multiple interior refits and new-builds on a largescale – millions of square feet – to set out a procurement strategy early on in the process. This strategy enabled the client to see where efficiencies and savings could be made. Pricing and buy strategies were set for virtually all major commodity items that tend to fluctuate in pricing, including furniture, fittings and equipment (FF&E) pricing in advance, and engaging directly with manufacturers, which resulted in significant savings. Protections were put in place to protect clients from cost escalations and incentives for manufacturers and suppliers should costs reduce past agreed upon pricing thresholds.

Benchmarking the outcome of such strategies is an important element of our approach. Comparing savings to cost data from similar projects enables us to identify inefficiencies and control the costs. Understanding what costs should be and how a potential development compares to similar projects can be the difference between success and failure.

**Conclusion**

In overheating markets soaring demand for commercial and residential property is a sign of growth. But with costs growing as much as at two to three times normal inflation rates, inevitably there are fears that this is a bubble that could burst.

But even in such a hot market, property owners, developers and tenants do not need to get burnt.

The strategies they can employ to avoid cost escalations or minimise the risk these pose work mainly because they benefit all parties – the client, the contractor and the manufacturer – setting up a virtuous circle of risk reduction to firefight overheating.

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With 90 offices in 38 countries, we draw on our extensive global and industry experience to manage risk while maximising value and performance during the construction and operation of our clients’ assets.

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