

Infrastructure and construction



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. It is crucial that the sector identifies, prioritises and delivers this infrastructure to enable the services to be provided such as transport, health, education, water, housing and provides wider social and economic outcomes. This can be achieved by adopting a strategic master planning approach to built infrastructure, integrated service design, employment opportunities and providing strong communication to the market of the project pipeline to build sector resilience and confidence.



Through the different COVID-19 response levels we have seen the huge impact on the economy, social and behavioral norms. The infrastructure and construction sector faces a new reality of:

- Changing public transport patterns.
- Heightened health and safety protocols on site.
- Rapid mobilisation of capital projects.
- Focus on the financial sustainability of the construction companies.
- Significant impacts on the private project pipeline.

The impact is amplified across these interconnected systems of critical infrastructure services and has needed a systems-based approach across sectors to identify the interconnected risks/ impacts and to collaborate on where to prioritise efforts to keep the system moving.

The Government is continuing to drive the investment in new infrastructure to stimulate the economy as typically \$1 spent in infrastructure is a \$4 multiplier in the economy. The Crown Infrastructure Partners 'Shovel Ready' Programme is targeted to help the sector recover and the overwhelming response for funding has opened the floodgates. The challenge will be in managing the expectations of organisations whose projects do not make the final list and how will they navigate alternative funding.

The pipeline for private projects has already seen a significant decline, particularly for significantly impacted sectors such as retail, hospitality, tourism (hotels), airports/ airlines and commercial property. The impact of this is not likely to be seen in Q3 and Q4 of 2020; activity will continue in the short-term as existing projects are completed following the lifting of lockdown levels. The industrial market has historically been a safer and lower risk investment for asset managers and therefore investment might retreat into this class, and could result in a steady pipeline, particularly in the agricultural/ food sector.

New Zealand's Construction Sector Accord has played a critical role in the sector response. The cross-sector Steering Group and transformation planning allowed the sector to respond effectively to the issues arising from the lockdown. The measures included:

- The release of procurement guidance for government agencies.
- Interpretation of contract clauses.
- Construction standards for health & safety in different lockdown levels.
- Guidance on new delivery models.
- Early release of retentions on government contracts; and
- Consideration of mechanisms to mitigate the risks and associated additional costs of delayed remobilisation to assist with contractor cash flow.

Imagine what would have happened if the Accord had not been developed in the last two years? Even with the considerable benefits brought by the Accord, the COVID-19 disruption means the construction sector may now be facing mounting pressures in terms of financial sustainability due to temporary project hibernation, alternative health and safety working practices, delayed cash flow for COVID-19-related variation claims, and potentially closed international borders that will impact the supply chain and the workforce.



For standard construction contracts, contractors should be entitled for variations for time and time-related costs, but the timing of negotiation and payment of these claim is uncertain and may impact contractor and subcontractor cashflow. In some cases, sub-contractors may not have terms in place which protect them; this is an even greater risk for those businesses that are less mature in terms of financial stability as they face significant strain on cash flow and a very real threat to their continued existence.

Contractors with either a balanced portfolio of government and private work or largely government work (particularly in the sectors above) will have less exposure to risk in the pipeline. They will also benefit from some of the initiatives taken by the Construction Sector Accord below.

What does this mean in practical terms once we move past the immediate crisis and financial resilience response? We expect to see a change in market dynamics, resulting in a shifting risk profile and the cost of delivery through factors including:

- a. Overall capacity and resources in the construction and consultancy sectors will be constrained, Demand is likely to exceed supply.
- b. Resources and capacity to undertake extensive pre-bid work at risk and incur associated bid costs further constrained/ no longer acceptable.
- c. Decreased market appetite for risk transfer on construction projects.
- d. Increased health and safety measures, and site performance risk management.
- e. Likely insurance issues on the back of insurers reassessing their ability to insure for pandemic related risks e.g. the impact of a second wave of infection in New Zealand.
- f. Extended claims negotiation and dispute with the potential to impact contractor cash flow.
- g. Restructuring of contractor businesses for the new normal.
- h. Potential cost escalation priced into contract costs due to:
 - i. Heightened risk profile if not shared.
 - ii. Inflated cost of materials given global market disturbance.

Fundamentally, project owners need to revisit the original assumption for new infrastructure needs to be revisited because assumptions of population shift, changing social norms e.g. increased working from home and economic growth predictions have significantly changed.



Future thinking – what could it look like?

The impact of COVID-19 could see the following situations happening:

- An increased requirement for Central Government and Local Government to fund the infrastructure portfolio and improve the visibility of the long-term project pipeline to support recovery.
- Consenting models could evolve to increase the use of offsite reviews through the use of technology and have more involvement in upfront planning processes (particularly for major projects).
- Alternative procurement and delivery models could be utilised to address project risk profiles, accelerate the project lifecycle, and increase confidence in the ability to deliver projects, as we saw after the Global Financial Crisis, and the Christchurch and Kaikoura earthquakes.

- The construction sector could look to de-risk their projects by increasing their supply chain resilience through potential partnerships, vertical integration or roll up.
- An increased focus on the environmental outcomes of projects e.g. carbon reduction and social procurement initiatives to strengthen the economy.

Infrastructure providers need to keep early stage projects moving; a lack of major projects ready to progress in 12-18 months could seriously hamstring the economic recovery. Contractors will need to retain key resources, look for long term productivity gains learned from a new working environment, explore partnerships to manage risk, and maintain strong cash flow management. It is also important the Government maintains capacity in the project planning, design and development stage of the infrastructure lifecycle to support the capacity and capability in the New Zealand workforce.

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