

INDEXATION 101 SESSION – CONTRACT PRICE ADJUSTMENT FOR COST FLUCTUATION – IMPROVEMENT PROJECTS

On 16 December 2021 and 9 February 2022 ‘Breakfast and Learn’ sessions were held to instruct Waka Kotahi NZ Transport Agency staff on contract price adjustment for cost fluctuations and its application to infrastructure improvement projects. These sessions were described as an ‘Indexation 101’ update but also introduced the temporary changes being made to indexation practice on Waka Kotahi state highway contracts, given the current escalation challenges.

Waka Kotahi has published a technical advice note ([TAN #21-21](#)) on the Waka Kotahi Highways Information Portal. It refers to a [Guidance note](#) entitled *Updated Approach to Cost Escalation in Waka Kotahi Physical Works Tenders*.

Waka Kotahi suppliers, contractors and consultants were invited to join the February session.

A [video recording](#) of this session is available.

Links to the other documents, and the web-based *Adjuster* tool, referred to in the presentation are as follows:

- [State highway construction contract proforma manual \(SMO31\)](#): Includes Schedule 17, which covers contract price adjustment for cost fluctuation. It is part of the conditions of contract document. For a design and construct contract the same schedule is Schedule 18.
- Detailed advice on the application of contract price adjustment for cost fluctuation is found in the [indexation instructions on the Waka Kotahi website](#)
- [Adjuster tool](#) does the calculations for contract price adjustment.
- The Guidance Note referred to in TAN #21-21 is also published on the [Waka Kotahi website](#).

Questions and answers

The questions asked by participants are listed below. Note that these are not verbatim and some of the answers are more comprehensive than those given at the time.

Question 1 - Given that most fluctuation (at the moment) relates to material costs - are calculating labour rates included as well given these should have been included as part of the original price and they are not rising in line with material fluctuations?

The Waka Kotahi indexes include a component for labour. So, across the term of a contract, if the cost of labour, as measured by the Stats NZ labour index we use, rises then the contractor will have more money available to them to cover the rising cost of labour. When tenderers prepare their tenders, they do so in the knowledge that the amount they will be paid will change (either increase or decrease) to reflect the ‘national average’ movement in the costs they face. Tenderers can be expected to take this into account in preparing their tender price – they can be expected to acknowledge that the principal is taking the cost escalation risk.

Question 2 - If our contractor is claiming [cost fluctuations] each month right up to the value of the current claim, [is] the Adjuster tool indexation up to date to capture the correct value for payment?

The fact that the Stats NZ index values for say the month of April are not published until August, is managed in the way described in the NZ standard general conditions of contract for building and civil engineering construction (Nzs3910). The contract price adjustment in any monthly progress

claim uses the latest published index values until such time as the correct index value for the month is published. The Adjuster does this for you. Refer section 2.7 *Letting the Adjuster take care of changes in the data used in calculations*, in the [instructions](#) for contract price adjustment for infrastructure contracts.

Question 3 - Is 'C' [the cost fluctuation adjustment] floored at zero, or can it go negative? How do you avoid contractors moving costs around between months to try to game the indexation? For example, with construction materials being so volatile, timing purchases versus billing could be quite profitable.

The cost fluctuation adjustment payment can be negative – refer clause 2 in Schedule 17 in the conditions of contract in SMO31. Waka Kotahi contract managers do need to make sure that, for the purposes of calculating the contract price adjustment, costs are attributed to the quarter in which the costs were due to be paid – for the bitumen volume-based part of the adjustment the volume of bitumen used must be attributed to the correct month. Contract managers can check that the correct amount is being claimed for fluctuations in a number of ways, including by having the contractor 'share' the Adjuster record with them - refer section 2.6 *Sharing contracts with other users*, in the [instructions](#) for contract price adjustment for infrastructure contracts. The principal's contract manager may choose to create their own contract record in the Adjuster.

Question 4 - What is the process for confirming contractor claims, i.e., do we just rely on Stats NZ or is there any other indexes used by Transport Agency?

The indexes Waka Kotahi uses are calculated from Stats NZ indexes. For advice on how to confirm the accuracy of a contractor's claim refer to Question 3 above.

Question 5 - Is Waka Kotahi going to pay both the indexed part (CI) and the bitumen volume-based part (CB) of the adjustment in first 12 months – or just the bitumen volume-based part?

Yes – the changes that TAN #21-21 advise include paying both the 'CI' and the 'CB' part of the contract price adjustment payment from contract commencement. Note that this applies to new contracts only – the terms of contracts already let do not change.

Question 6 - I suggest that clause 3 [in SMO31 conditions of contract Schedule 17] be rewritten to make it clear that a combination of indexes (i.e., 'Structures' and 'Construction other than structure') can be used ... RFT writers may not be aware?

The instructions to RFT writers, included in Schedule 17 as presented in SMO31, draw attention to the fact that the use of two indexes is sometimes necessary. They include this statement 'Appendix 3 to [Contract Price Adjustment for Cost Fluctuation: Infrastructure Contracts](#) describes how that should be done and provides two alternative models for this Schedule 17.' Some additional words in clause 3 to reiterate this may be warranted and could be included when SMO31 is next updated.

Question 7 - How dynamic is the Adjuster to changes in market conditions? If further changes are required what is the process for any potential changes required in the Adjuster to react to the market etc?

The Waka Kotahi indexes (and therefore the amount being paid as contract price adjustment, as determined by the Adjuster) are reacting to the current market situation. However, there are issues with the current market situation that cannot be fully addressed by taking a 'business as usual' approach – TAN #21-21 and the [Guidance note](#) discuss ways in which some of these escalation related issues could be managed.

Question 8 - Is the change retrospective, [that is the change to clause 3 in SMO31 conditions of contract, schedule 17 – which will mean that the index-based part of the contract price adjustment (CI) is paid from contract commencement]?

The change is not retrospective. The change to clause 3 applies to new contracts – the terms of existing contracts are unchanged.

Question 9 – Please confirm when the adjustment applies from, [and what is the relevance of the] tender close date?

Contract price adjustments on new contracts are to be paid from contract commencement – from when work commences. The tender close date is relevant to the calculation of monthly contract price adjustment amounts only – the calculation of CI is based on the value of the relevant index in the month in which tenders close and in the month in which the work is delivered. Similarly, the calculation of CB is based on the value of the bitumen cost adjustment series in the month in which tenders close and in the month in which the work is delivered.

Question 10 - Does indexation account for regional ‘hot spots’?

No - all Waka Kotahi indexes are based in Stats NZ information which is national information. Indexes therefore move to reflect ‘national average’ price movements. Issues impacting a specific contract in a particular region need to be considered locally by those representing the parties to the contract.

Question 11 - Is the change [referred to in TAN #21-21 and the Guidance note] mandatory for local authorities?

No – the State highway construction contract proforma manual (SMO31) is available for local authorities to adopt and adapt but its use is not required by Waka Kotahi funding assistance policy.