

Technical webinar:

# Project management in the context of public procurement rules and cost increases

Directorate-General for Regional and Urban policy (DG REGIO)

Directorate-General for Internal Market, Industry, Entrepreneurship  
and SMEs (DG GROW)

Webex, 12 July 2022



# Housekeeping rules

## Default settings (unless speaking)

- Cameras switched off
- Microphones are muted by default

## If you want to ask a question

- Ask for the floor in the chat and you will be unmuted to ask the question
- When writing in the chat, make sure you address the message to everyone (not only to host)

## Webstreaming

- [Webstreaming](#) available following the link (no participants limit)

## The webinar will be recorded

- Presentations and recording will be available on Info REGIO after the webinar

# AGENDA

Introduction and the purpose of webinar - (DG REGIO and DG GROW)

Challenges for public procurement in construction (DG GROW.H1)

Modification of contracts in the light of PP Directive rules - DG GROW.C1

Project management of EU-funded projects – cohesion policy rules – DG REGIO.02

Next steps





# 1. Introduction

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## 2. Challenges for public procurement in construction



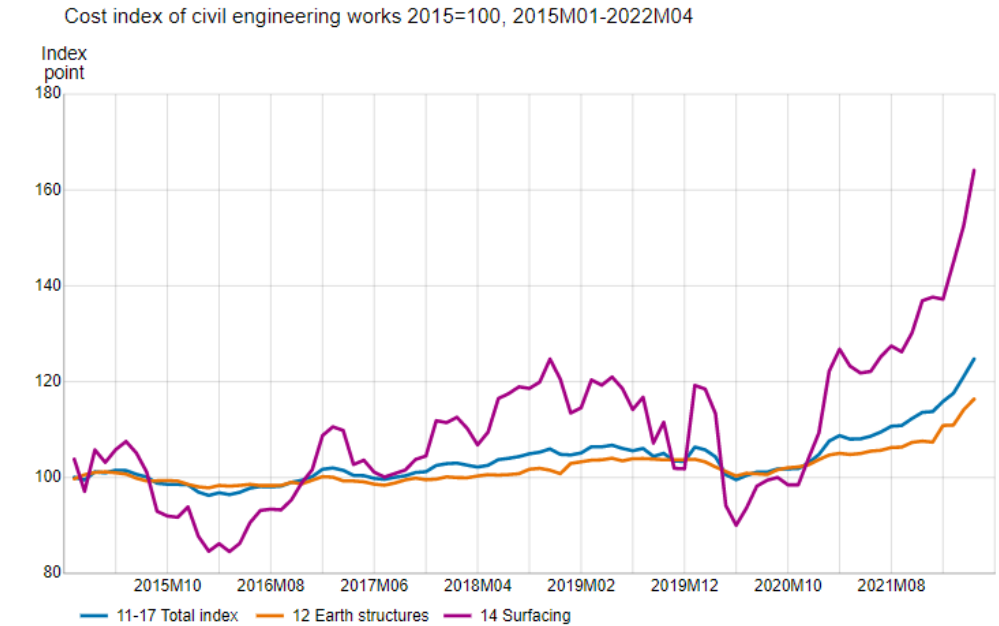
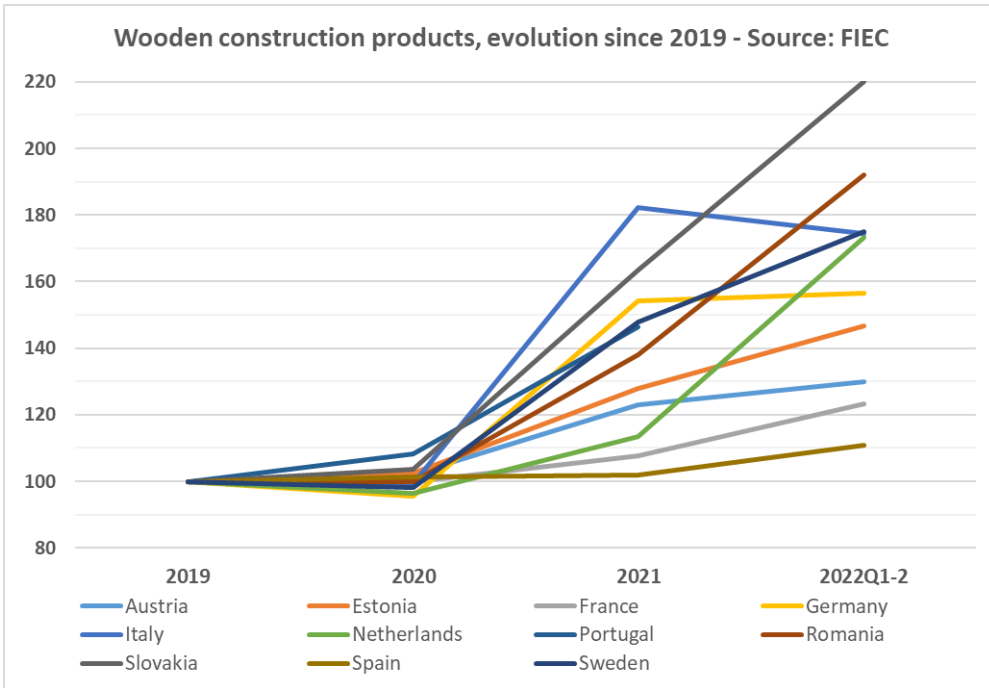
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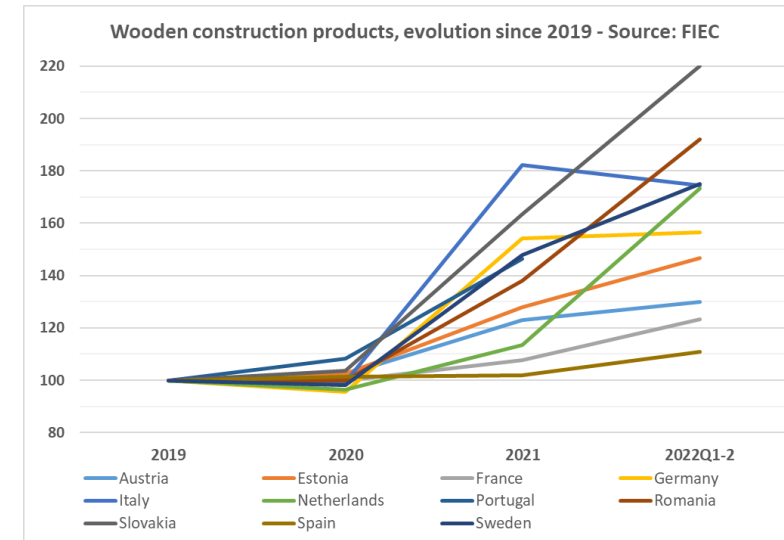
# The price evolution of wooden construction products in EU since 2019



Source: Statistics Finland, cost index of civil engineering works

# The price evolution of construction products in EU since 2019

- Wood and road surfacing are just examples of how many construction materials and products (steel, aluminium,...) have undergone price increases
- Strong **post-COVID price increases** in 2021
- **Additional price hikes since start of Russian invasion** in March 2022: up to 40% in some MS
- In many MS: increases between 60% and 120% since 2020
- Large differences between MS: one cannot draw a general picture for EU as a whole
- Differences between stages of a construction project
- Caused by a complex combination of factors, often related: demand increase, sanctions and other war-related supply disruptions, general inflation, lack of workers, rising energy prices and possibly stockpiling generating artificial inflation



# Problems with public procurement in construction

- As public construction projects typically take up periods of more than 1 year, they are **inevitably affected by price evolutions** that are impossible to predict.
- The solution, often applied, is price indexation mechanisms
- However the **point of view of both sides of the contract** should be taken into account
  - **Public buyer:** will in many cases need at least some guarantee on the final nominal cost of the project, for budgetary reasons → caps applied
  - **Public buyer:** wants to attract companies in good faith, not underestimating the price risk
  - **Private construction company:** will expect a reasonable share of price increases to be contractually covered
  - **Private construction company:** will refuse to bear the full price uncertainty in a volatile situation, in a risk market that can attract firms in bad faith


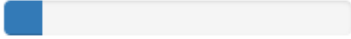
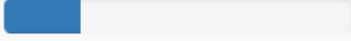
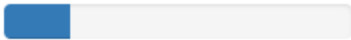
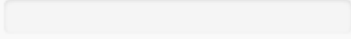


# Problems with public procurement in construction

- In periods with relatively stable prices, a fair balance of risk sharing through indexation mechanisms can be found
- In periods of extreme volatility, this balance is hard to find resulting in public buyers postponing projects and private companies refusing to tender. **This is the problem of new construction projects**
- In periods of extreme volatility, contracts are often ill-prepared for extreme price increases, resulting in problems for the continuation of the project. **This is the problem of on-going contracts**

# Survey

## Describe your work/role

		Answers	Ratio
I am a public client, or work in a public authority and/or involved in public procurement for construction		54	54.55 %
I work in the broad construction industry and I am involved in tenders/contracts for construction works.		11	11.11 %
I am a construction professional or represent construction professionals		22	22.22 %
Other		19	19.19 %
No Answer		0	0.00 %

- Overall **goal of the survey**: gaining insights into the application of indexation mechanisms and the reasons why they may or may not work
- 106 participants
- **Most MS represented**: BE, CZ, ES, EE, ES, FI, HR, IE, IT, LU, NL, PL, PT, RO, SE, SI
- Many **national or regional authorities** being big buyers of public construction works
- Many **industry associations** reporting on behalf of their members
- CEO's and tender managers from large construction companies

# Results: use of price revision clauses

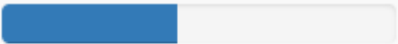
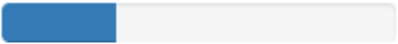
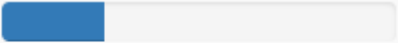

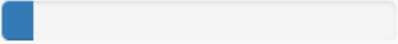
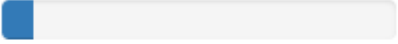
Do the contracts that you manage (as public authority/client) or have to deliver (as contractor) include price revision clauses?

		Answers	Ratio
Yes		39	39.39 %
No		41	41.41 %
I am not sure		17	17.17 %
No Answer		2	2.02 %

- At least **some kind of price revisions usually applied in most MS**: BE, CZ, DE, EE, FI, LU, NL, PT, SE, SI
- Specific mention of ES as a MS with strict regulation on price revisions and little price revisions in practice
- Respondents replying “no” are often not contractors but **material providers** (wood, asphalt,...)

# Results: issues with price indexation

Do you identify any issues with the indexations?

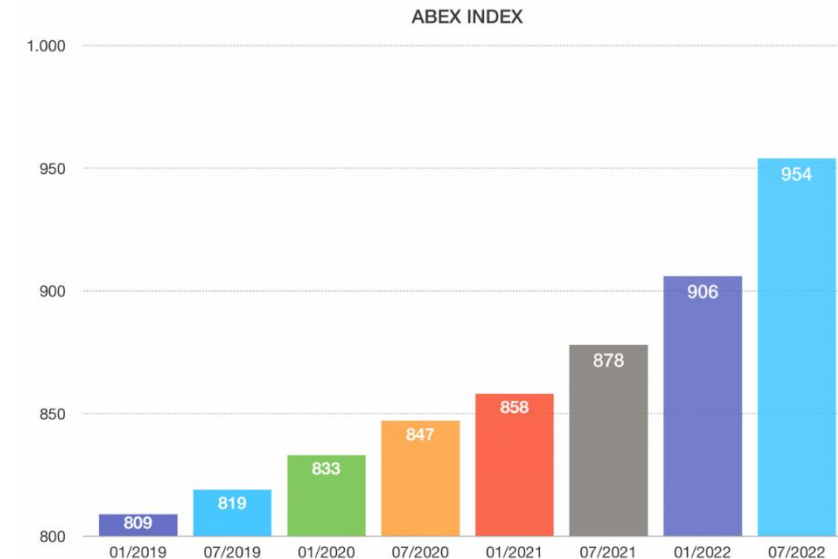
		Answers	Ratio
Price revision should be more frequent		44	44.44 %
The weighting should be improved		29	29.29 %
The ceiling for revision is not satisfactory		26	26.26 %
It is challenging to draft indexation clauses		48	48.48 %
Other		8	8.08 %
No Answer		8	8.08 %

- General acknowledgement that drafting indexation clauses is challenging
- Most answered issue is the **frequency of the price revision**
- Other problems often mentioned
  - **Weighting** to be improved
  - **Ceiling** not satisfactory
  - **Limited** index: eg only bitumen in EE
  - **Periods of non-application** (1-2 years)

# Results: issues with price indexation

- Usually the problem is not the non-existence of price revision clauses, but the **discrepancy between the price revision and the market situation**
  - Indexations lagging behind
  - Indexations being capped
  - Indexations not reflecting the construction works
- Strong message about the **trade-off** between
  - increased flexibility of contracts
  - budgetary security for public authorities

→ Price risk needs to be shared in a fair way
- Strong message about **market differences** between MS
  - No calls for European-wide indexation mechanisms
  - **Many calls for more and more transparent market figures on national level to be used as a strong basis for price indexations**



Building costs index applied in Belgium

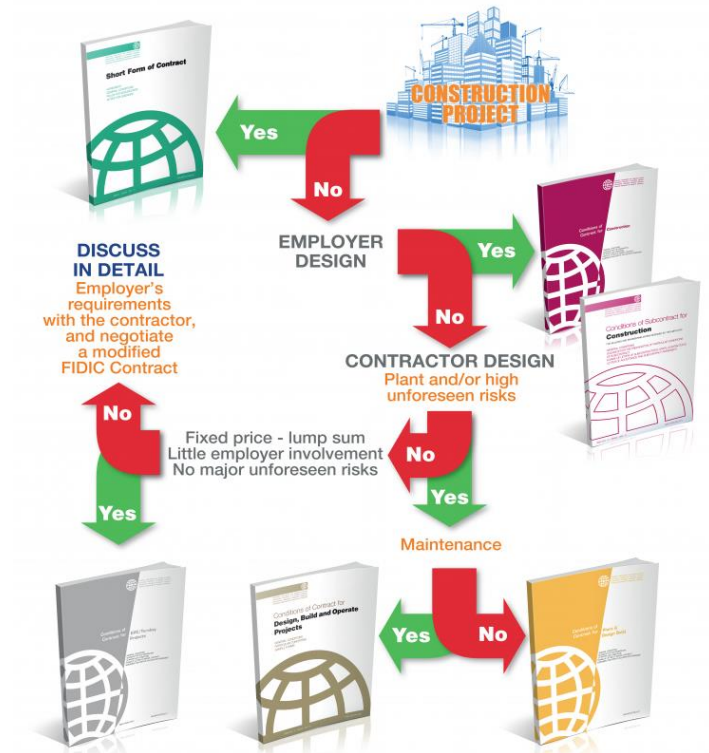
# Results: best practices

- Some **examples** to be checked
  - Specific **indexations**
    - FI has multiple indexes for bitumen, stone aggregates, labour, fuel, steel products;
    - IE working with a retro-active system,...
    - SE mechanism: well-weighted and frequently updated
  - German Bauindustrie **guidelines for price revision** clauses
  - Some MS issued national recommendations about modifications of running contracts - **Ukraine War to be invoked as force majeure**
  - Many references to standardised contract forms



# Final remarks

- The greatest ambiguities arise among respondents in the area of
  - The application of “**force majeure**” or “**unforeseen circumstances**” in running contracts
  - **Compliance of certain compensations** with competition law and other EU legislation
- Other remarks
  - The extremely **flexible contracts of material suppliers** often put strong pressure on the construction companies
  - Many public authorities are **postponing projects** due to off-budget recalculations
  - **EU-funded projects under pressure** due to rising prices and the nominal amount of aid committed
  - More structural problems in construction than contracts, notably the availability of **skilled workforce**





## 3. Modification of public contracts

Katharina Knapton-Vierlich, HoU, DG GROW, Public Procurement

**DG for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW)**



# The Beast and the Beauty

- **Material changes = new procedure**
  - **Scope**
  - **Mutual rights and obligations**

- **Minor changes = no new procedure**
  - **Below a certain value**
  - **Additional works**
  - **Unforeseeable circumstances**

**Is that the magic wand?**



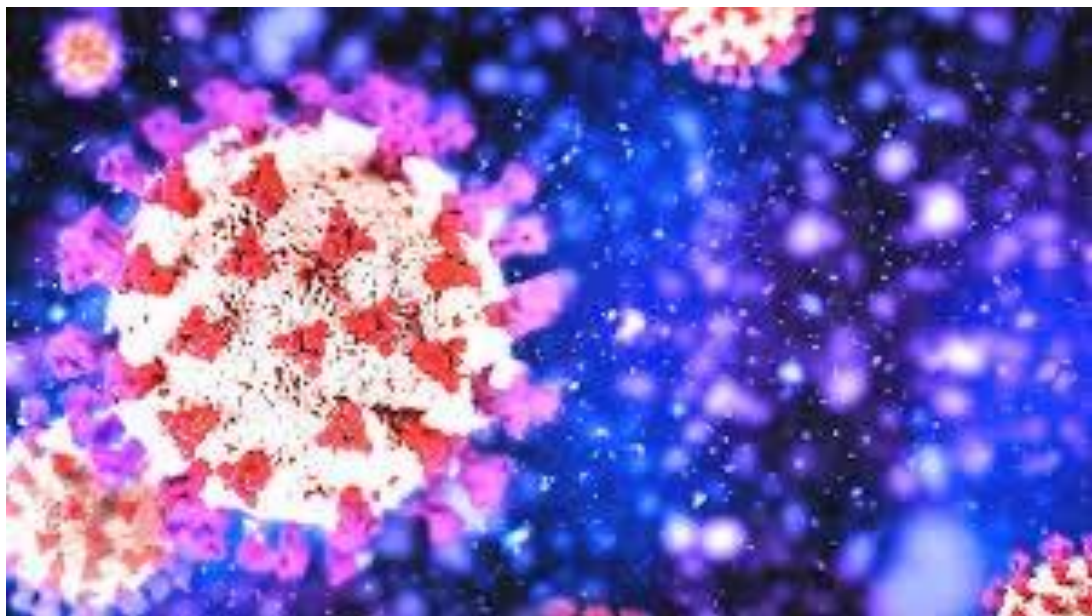
# Article 72 (1) (c) of Directive 2014/24/EU

- A need for modification **due to**
- Circumstances that a diligent contracting authority could not foresee

- It does not alter the overall nature of the contract

- Each increase is not higher than 50 %

# The unforeseeable circumstances



# Is that enough?

- **Is there a price rise for this particular material/in this particular contract?**
- **Is the price rise within the margins of normal market behaviour that should have been foreseen?**
- **Does the contract contain a price revision clause?**

# How much price increase? It depends

- **Objective criteria in the contract provisions**
- **Statistical price index**
  - Objective and verifiable
  - Related to the subject matter
  - Related to the region
  - In general adequate

- **Take original calculation into account**
- **Maintain the original contract balance**
- **Possibilities of retendering**
- **Budget constraints**
- **Envisage burden sharing**

# Is that all? A few further points

- **A right to contract modification?**
- **From when is the modification applicable?**
- **Horizontal measures regulating price increases**
- **Modification and specific state aid**
- **Modifying tenders?**
- **Negotiated procedure without publication of a contract notice?**



## 4. Programme and project management of EU-funded projects under cohesion policy in the situation of price hikes and distortions in supply chains and labour force

Witold Willak  
Deputy Head of Unit DDG.02 Coordination of programmes

**DG for Regional and Urban Policy (DG REGIO)**



# How to deliver selected operations in the situation of price hikes and distortions in supply chains and labour force?

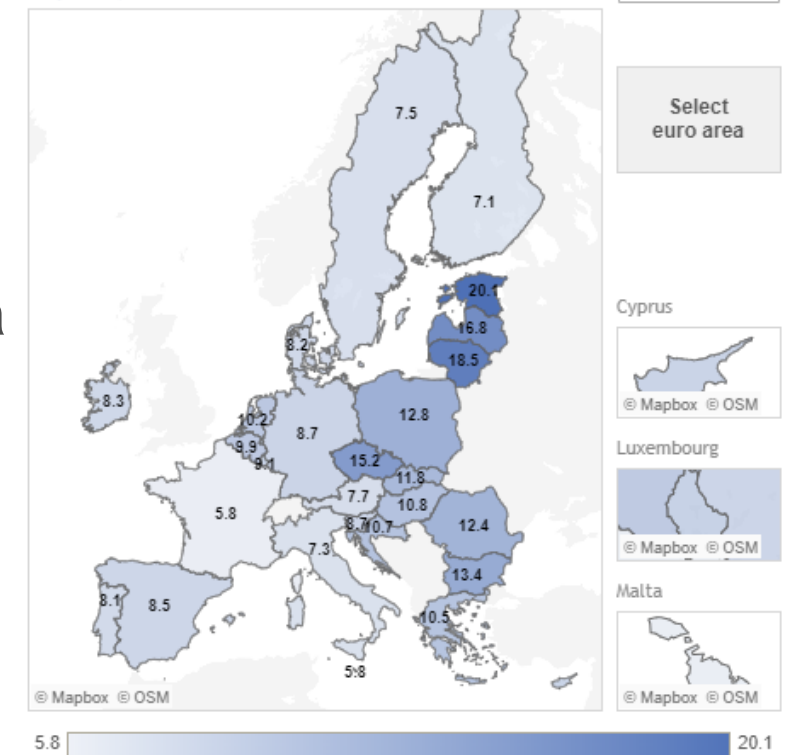
- **ECB: HICP inflation ([source here](#)) is projected to decrease to 3.5% in 2023 and 2.1% in 2024**
- **Should we wait for markets to stabilise?**
- On the one hand, the projections might not materialise... on the other, end 2023 is approaching - then phasing is a solution.

(annual percentage changes)



Note: The vertical line indicates the start of the projection horizon.

HICP inflation rate - Overall index  
May 2022, EU countries



# Increase in costs of projects vs. cohesion policy

## Cohesion policy 2014-20

- significant share of projects still implemented (contracting approx. 100%, avg. payment to COM 68%), especially large ones (major projects adopted by COM decision)
- **REACT EU** resources added in 2021 and 2022 – to be spent quickly
- Eligibility period ends on **31 December 2023**, COM position not to extend but,
- **Simplified phasing of projects** offered (Art. 118 CPR 2021-2027, draft Art. 118a)
- Further changes to **2014-2020 closure guidelines** planned

## Cohesion policy 2021-2027

- ongoing programming, hence impact of cost increases on target setting for indicators and on starting new projects

# What is phasing?

- **Phasing** consists of financing a project from two programming periods of cohesion policy
- For projects that span over the periods 2014-2020 and 2021-2027, **Art. 118 of the EC Reg. 1060/2021** specifies the conditions
- Normally and ideally all operations should be **started, completed and functioning** within the single programming period, but
- **Project timing** does not always coincide with programming periods - phasing is useful to avoid any negative influence of **MFF timing** on projects
- The CPR **does not allow phasing over 3 programming periods**

# Changes to rules on phasing in CPR 2021-2027

- Proposed new Article 118a
  - **Facilitated conditions for phasing** to ensure the continuity of delayed projects
    - **Lower the regulatory ceiling for the possibility to phase operations from 2014-2020 to 2021-2027** (EUR 5 million → EUR 1 million) – for operations selected for support from the 2014-2020 programmes and started before 29 June 2022, and
    - Allow for direct granting by the managing authority, provided that a limited number of key conditions are met – hence **ensuring their full eligibility in the 2021-2027 period despite stricter rules**
- Proposed amendment to Annex I - Table 1
  - Add **dedicated intervention fields** to cover phased operations that would otherwise not be eligible for support in 2021-2027

# How to deliver selected operations against price hikes and distortions in supply chains and labour force?

- Two basic options for problematic operations with **ongoing procurement**:
  - modify the existing contract in terms of either time, scope, and/or prices
  - contractor decides to terminate the contract and the CA needs to re-tender
- In case the contracting authorities decide to continue with specific operations, **who can cover additional costs**:
  - Beneficiary
  - Other national funds
  - **EU support can be increased** if programme still has resources, otherwise phasing should be considered and resources from 2021-27 added to the project

# When to modify grant agreements of selected projects?

- As each project has a different timing and content, **a case by case** assessment is required, but can be facilitated by national legislation/guidance
- MA to observe **EU and national rules**, and respect the principles of sound financial management, proportionality, equal treatment, non-discrimination, transparency in all their actions
- Respect conditions of original call unless **force majeure can be invoked for the operation** at stake, and provided that the adjustments are limited to what is necessary to implement the operation.
- In general, the grant agreements can be modified as regards **substitute / delayed performance or budget**.
- **For major projects**, new updated documentation is to be sent to DG REGIO either via JASPERS Independent Quality Review or directly.

# Project management in cohesion policy – experience and solutions

- **Indexation clauses** – best tool to optimise and balance the risks related to market fluctuations
- It should be applied without **any limits, based on an objective and verified methods based on statistical data**
- Some Member States do **the capping of indexation clauses** reducing its utility
- **Indexation can work upwards and downwards** so it protects the interests of both sides
- Let's use indexation in all affected EU-funded projects, coupled with wider use of phasing

# Project management in cohesion policy – lessons for future

- **Public procurement** is one of the most important stages of ensuring project quality, translating ideas into reality but is also a main source of irregularities:
  - Part of ex ante conditionality/horizontal enabling condition
  - Promoting strategic procurement
  - Integrity Pacts
- Different practices of Member States in project management based on different administrative practices
- Normally, forecasting and managing the cost of projects is part of know-how of the contracting authorities and contractors – but optimism bias is quite frequent



# Various tools to control costs and a risk of cost overruns ex ante

- **Cost-Benefit Analysis** and other methodological approaches to compare costs and benefits over the reference period
- **Risk assessment** including sensitivity analysis – how a project behaves in different economic situations and which variables are critical
- Proper and mature **documentation**
- **Contingencies and price adjustments** (indexation clauses)

# Programme management in cohesion policy – experience and solutions

- Managing authorities can increase **EU grants to projects either within the current period 2014-20** (if there are spare resources in the programmes) or **by phasing and adding 2021-2027 resources to ongoing projects**
- In case of budgetary and/or policy constraints, **the prioritisation of projects might occur**, and should be always policy-oriented (e.g. priority to Green deal)
- The projects should ideally be still **financially sustainable and economically viable**
- **JASPERS advisory divisions** can advise on larger/complex project modifications, value engineering during the phasing, and on recalculating the CBAs (in case they are required)
- **DG GROW** is also there to help with procurement procedures
- **State aid issues** might require additional clarifications in terms of amount of public aid

# Major projects modifications

**Good practice examples** of information to be submitted within major project modification request:

<p><b>Clear explanation what happened</b> to the project since original application / decision (procurement, implementation; separated per contract if relevant)</p>	<p>Concise <b>overview and explanation of changes</b> explained in updated Application Form and in accompanying document is recommended (comparing first submission vs modification; e.g. cost breakdown, timetable)</p>	<p><b>All relevant parts of original documentation</b> that are affected by modification <b>should be updated</b> (e.g. demand analysis, CBA, unit cost justification, etc.)</p>
<p>If applicable, <b>updating demand analysis</b> to account for new situation, e.g. modified project scope. (e.g. no need to build new traffic model in standard situation; rather compare original traffic model results with those after modified scope)</p>	<p>If applicable, analysing impact of modification on <b>option analysis and its outcome</b> (new scope or costs may lead to different outcome of option analysis).</p>	<p>Updating <b>cost-benefit analysis</b> in case of cost variations.</p>

# Major projects modifications

**Good practice examples** of information to be submitted within major project modification request (II):

<p>Analysing impact of cost changes on <b>unit costs</b> of main project expenditure items and justification vs. cost benchmarks. (explanations on the comparison of modification vs. first submission unit costs)</p>	<p>Analysing <b>macroeconomic/market impacts</b> on the project with reliable and quantifiable data. (cost increases backed by statistical indices, procurement situation, market situation; sectoral/national aspects)</p>	<p>Analysing <b>financial sustainability</b> and <b>sources of funding</b> also for the modified project. In case modification includes phasing into 2021-27 period, <b>commitment of funds for phase 2</b> in the Application Form.</p>
<p>Adjustment of <b>risk analysis</b> to modified situation (comparison with original risk analysis; analyze success of original mitigation measures)</p>	<p>Clear <b>justification of revised timetable</b> in case the project needs to be implemented in a longer time period</p>	<p>In case of need for support, you may <b>consult JASPERS Advisory</b> in advance for the preparation of modifications is recommended.</p>



## 5. Next steps

DG GROW  
DG REGIO

# Thank you

