



CITY OF
ST. CATHARINES

Corporate Report

Report from Transportation and Environmental Services, Engineering and Construction

Date of Report: June 24, 2013

Date of Meeting: July 8, 2013

Report Number: TES-188-2013

File: 18.20.99, 18.45.99

Subject: Reporting of Construction Contract Expenditures

Recommendation

That Council receive this report for information purposes. FORTHWITH

Summary

In February of 2013, Councillor Harris requested a report that described the Region of Niagara's policy for the management of overages on construction projects and reviewed the feasibility of the City of St. Catharines adopting a similar policy. This report is in response to that request.

Background

Council at its meeting of February 25, 2013 approved the following:

"That staff be directed to prepare a report to explain the reasoning behind the Region's policy for overages on construction projects and feasibility or lack of feasibility for instituting a similar policy in St. Catharines."

Niagara Region has a purchasing Policy (By-Law 130-2010). The policy includes upset limits which govern the method of purchasing (invited quotation, public tender, sole source or negotiated), delegated spending approval limits for Staff, and Council reporting procedures for normal expenditures and special circumstances or emergencies.

The City of St. Catharines has a purchasing policy and it has a delegation by-law. The City policy is very similar to the Region's policy in many respects but deviates substantially in others such as staff spending authority limits and Council reporting requirements.

The Region's budget process usually includes an Emergency Capital expenditure account (per Public Works division) of \$1,000,000 annually and after tenders close staff evaluate project budgets and any surplus funds are immediately transferred to holding account. That holding account may be used to fund other project overruns or

emergency expenditures. Approval to fund new expenses from these two funding sources is detailed later in this report.

In the City's budget process, all approved funds for a project are retained within a project's individual accounts until project completion unless Council approves a Budget amendment to use a portion of those funds for another project. Council approval is required for all budget amendments.

Report

The following discussion summarizes the relevant policies and procedures for both the Region of Niagara and the City of St. Catharines with respect to the financial management of construction contracts, specifically, the treatment of cost overruns within an awarded construction contract.

Niagara Region

The subject of construction costs and the treatment of cost overruns had been tabled recently at Regional Council. Region report CSD 53-2013 has been attached as Appendix 1 of this report as it provides a concise overview of the policies and protocols applicable to the Region.

In general, the Region's Purchasing Policy (By-Law 130-2010) provides the guidance for decision making, approval authority and reporting with respect to awarded construction contracts. The Region's policy has two provisions which apply to ongoing construction contracts. The Region's policy requires a request for tender be called for all construction tenders greater than \$250,000 (Provisions 7a and Schedule "C"). However, Staff may approve the purchase of all Special Circumstances or use a Negotiation method of acquisition for purchases less than \$1,000,000. In simple terms, staff has the delegated authority to approve increased expenditures through "sole source" or "negotiation" that meet the definition of "special circumstances" or "emergency", all subject to the terms of the purchasing policy.

Regional staff have indicated that during an active construction contract when unanticipated conditions arise which result in increased expenditures and where the intent of the proposed work does not change, the unanticipated conditions are treated as an "emergency" as defined by the purchasing policy. Consequently, the construction project management staff negotiates pricing with the contractor, and directs the contractor to proceed with the modified construction plan through a change order process. Using this method allows the changes to be handled in a timely manner. The Region does not incur substantial stand-by or delay charges by the contractor nor does the Region prolong any service interruption to the public.

Once final construction costs are determined, a memo is prepared by staff for the Commissioner of Public Works detailing the reasons for the change orders and associated cost increases. Information in these memos form part of the Treasurer's report which is presented quarterly to Regional Council as required in Section 23 of the by-law.

The Region is currently undertaking an internal review of the communication of a project's status to determine if the timeliness of the status update can be improved.

City of St. Catharines

Much like the Region, the City's approved Purchasing Policy provides the guidance for decision making, approval authority and reporting with respect to awarded construction contracts. The City's Procurement Policy contains two sections similar to the Region's:

From Section V – Emergency Purchases the following is excerpted:

Where a situation arises requiring the immediate procurement of goods or services essential to prevent serious delays in the work of any Department or which might involve danger to life, health or safety of employees or the public, or to prevent damage to property, a Department Director may purchase the required goods or services notwithstanding any other provision of this policy....

For purchases exceeding \$75,000, as soon after the purchase as reasonable possible, the requisitioner shall notify the Purchasing Agent with a written report detailing the circumstances. A report to Council will be required.

From Appendix C – Purchase by Negotiation the following:

All purchasing of goods and services shall be by a competitive method except for the following where the negotiation method would apply:

8. when the extension or reinstatement of the existing contract would be the most cost effective or beneficial method and is in the best interest of the City;
9. when an emergency, where goods and services are deemed necessary and time and safety concerns reasonably limit the use of any other prescribed procurement process; this would include fulfilling a statutory order issued by a federal or provincial authority, such as an environmental, public health or workplace safety compliance order;

Authority to incur expenditures of City funds through the negotiation method shall be subject to the same spending approval levels as outlined in Section III of the policy.

It should be noted that Region's Staff delegated approval limits and contract execution limits are much higher than City staff limits. Specifically, those limits assuming an approved budget is in place are \$75,000 for the City's CAO and \$1,000,000 for the Region's CAO.

Nature of Cost Overruns

Unanticipated conditions which result in increased costs to a contract are not unusual during construction in a municipal environment. The City's awarded construction

tenders typically include a contingency of approximately 5% to fund unforeseen or unanticipated expenditures. There are, on occasion, instances when the final construction amount cannot be accommodated by the contingency allowance and the awarded tender amount is exceeded. Historically, unforeseen or unanticipated conditions that lead to additional costs have included, but have not been limited to the following:

- Inaccurate construction records for old infrastructure;
- Inaccurate records for underground utilities;
- Delays associated with the relocation of utility infrastructure;
- The repair of existing watermains during construction;
- Increased scope of property restoration due to weather conditions;
- Increased scope of roadway restoration confirmed in the field.

In recent years, in response to repeated concerns expressed by the construction industry, design and construction techniques have undergone a change. This change has created some challenges for municipalities specifically associated with project budgets and construction costs. This change has been initiated in order to reuse as much of the native excavated material on site as possible thereby reducing the amount of fill material generated by the project that must be disposed of. This change has obvious environmental benefits as it reduces waste and it reduces the amount of granular backfill required to be quarried and produced. The limitations of this construction practice are associated with the suitability of the material to be reused, the quality of workmanship of the contractor and the weather conditions encountered during construction. The challenge that Staff face is that when this construction practice is called for through the tender and the then actual site conditions require the contractor to revert back to conventional construction techniques, a significant cost increase results. This cost is directly related to the supply of the new granular material. It should be noted that the unit price for the granular material is established competitively in the contract. However, the estimated quantity of material in the contract is under estimated. This particular issue / challenge was encountered on the Lake Street construction project and is the subject of a separate report before Council. Staff has contemplated the inclusion of both construction techniques in the contract in order to accommodate either construction practice. However, this would unnecessarily inflate project budgets. Alternatively, staff has concluded that all tender calls will require the traditional construction practice, but also include provisions for the substitution of the “reuse” technique if conditions suit and there is no additional cost to the City.

Financial Implications

The financial implications associated with any given project or construction contract are considered throughout the life of the project from preliminary design to budget approval to final completion of construction. All construction contracts are managed financially in accordance with the City's approved procurement policy. In the event that a construction contract is anticipated to go over budget, staff is required to report to Council on the financial implications and provide an explanation for the increased cost. Although the timing of that notification is generally a function of the amount of the overrun cost, it is preferred to notify Council as soon as such an overrun is either known

or reasonably anticipated. Similar to the Region, staff sees an opportunity for improved timeliness of this notification.

Conclusion

The policies and procedures for both the Region of Niagara and the City of St. Catharines with respect to the financial management of construction contracts are quite similar. Their respective Purchasing Policies provide the guidance for decision making, approval authority and reporting with respect to awarded construction contracts.

Staff is of the opinion that the current policies operate well to strike a practical balance between procurement best practices and the often urgent need to respond to unforeseen site conditions or construction challenges encountered during a construction project.

Notification

Staff is of the opinion that notification to the Council regarding anticipated contract overruns should be undertaken as soon as is reasonably possible / practical regardless of dollar value.

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REPORT TO: Corporate Services Committee

SUBJECT: Capital Asset Management Policy Review

RECOMMENDATION

This report **BE RECEIVED** for information purposes.

PURPOSE

This report responds to a staff direction made at the February 20, 2013 Corporate Services committee meeting.

"That Corporate Services committee recommend to Council that Regional Council direct staff to examine the Capital Asset Management Policy and the Procurement Bylaw and recommend improvements to increase communication to better facilitate approvals by Regional Council for potential cost overruns."

BUSINESS IMPLICATIONS

This report outlines the process that whereby project cost overruns are communicated internally and approved by Council in alignment with the capital asset management policy (CAMP) and the purchasing policy and that appropriate funding is assigned in accordance with the CAMP.

REPORT

Recent questions by Council regarding capital project cost overruns have brought attention to the capital asset management policy and the purchasing policy. Clarification has been sought on the approval and communication of cost overruns and how they are funded.

Project managers are responsible for monitoring the approved scope of projects and taking appropriate action when unanticipated project scope changes occur, particularly where cost overruns or potential cost overruns are identified. Corporate Services carries out regular project variance reporting to assist in the identification of projects with budget to actual funding deficits.

The CAMP requires that cost overruns be recorded and reported both internally and to Council. Council reporting is done either by way of the quarterly variance reports or project close-out reports. Where funds are required as a result of unforeseen capital costs greater than \$250,000, a report must go to Council for approval prior to the use of the funds.

Where a cost overrun is determined a "special circumstance" the purchasing policy takes precedence over the CAMP. Section 2 of the purchasing policy defines a special circumstance as follows:

- (i) *an event that is exceptional or could not be foreseen and is likely to pose a threat to the health, safety or welfare of the public;*
- (ii) *an event that, unless immediately addressed, is likely to cause significant loss or damage to property;*
- (iii) *an event that has disrupted any essential service that needs to be re-established without delay; or*
- (iv) *an emergency as defined in the Emergency Management Act, R.S.O. 1990, c. E.8, as amended, or any successor legislation thereto;*
- (v) *in these instances work continues while a report is prepared to Council.*

For special circumstances, purchases must be reported to purchasing services on the following business day and contracts to address the additional work are required to effect special circumstances purchases and be signed in accordance with the document execution authorities set out in Schedule "C" of the purchasing policy (refer to Appendix A for details). In addition, on a quarterly basis, the Treasurer shall submit reports listing all purchases of goods and services through bid solicitations in excess of \$25,000 for information to Committee and Council, with an alphabetical listing of suppliers, total award, amount budgeted, and description of goods and services. It is recommended that a similar reporting process internally and to Regional Council be required following special circumstance cost overruns that exceed \$250,000. This would align with the reporting threshold of the CAMP and could be implemented immediately.

Appendix B provides a flow chart that summarizes the steps to be taken with respect to overruns.

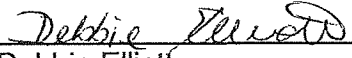
NEXT STEPS

Staff have begun a review of the CAMP with input from departments. Corporate Services staff will continue to meet with the financial leads of departments to develop an education session that will review the existing policies, the processes for both, reporting requirements and other relevant information within the capital asset management policy and purchasing policy. The education sessions will be provided to all relevant capital project staff, completed prior to the end of the year and tracked within the Peoplesoft system.

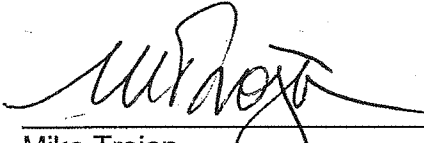
REPORTS PERTINENT TO THIS MATTER

N/A

Submitted by:


Debbie Elliott
Acting Commissioner of Corporate Services

Approved by:


Mike Trojan
Chief Administrative Officer

APPENDICES

Appendix A - Purchasing By-Law Schedule "C" – Purchasing and Execution Authority
Appendix B- Flow Chart – Approval and Funding of Capital Project Cost Overruns

This report was prepared by Beth Brens, Capital Program Manager and Margaret Murphy, Associate Director, Current & Capital Budgets, in consultation with Chris McQueen, Acting Director, Financial Management & Planning, Jennifer Feren, Director, Legal Services, and Glen Cowan, Associate Director Public Works Finance.

Appendix A - Purchasing By-Law Schedule "C" – Purchasing and Execution Authority

Method Of Purchasing	Dollar Value	Purchasing Authority	Document Execution Authority	Type Of Agreement With Supplier
Special Circumstance, Single Source and Negotiation	> \$10,000 to \$25,000	Department Associate Director or Designate	Department Director	Purchase Order or legally executed agreement
	> \$25,000 to \$50,000	Department Director or Designate	Department Commissioner	
	>\$50,000 to \$100,000	Department Commissioner or Designate	Department Commissioner	
	> \$100,000 to \$250,000	Department Commissioner or Designate and Treasurer or CAO	Department Commissioner and Treasurer	
	>\$250,000 to \$1,000,000	Department Commissioner or Designate, and Commissioner of Corporate Services	Department Commissioner and Commissioner of Corporate Services	
	>\$1,000,000	Council	Regional Clerk and Regional Chair	

Appendix B - Flow Chart – Approval and Funding of Capital Project Cost Overruns

