



# Foresight

## Australia's road and rail market

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### **“Meeting the market”: Australia's infrastructure boom drives smarter procurement models.**

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With Australia in the midst of a massive, infrastructure construction boom, government agencies are finding smarter ways to structure mega deals, offering lessons for procurement teams around the world, whatever market conditions they face.

#### **Snapshot of Australia's construction market**

Right now, Australia's construction market can be described as 'hot', as the country rolls out an unprecedented number of giant infrastructure projects, many valued at over US\$2 billion, particularly in the southeastern states where numerous road and rail renewal programs are underway, alongside a large number of Commonwealth infrastructure programs.

These investments, which include building out new urban rail systems and expanded motorway networks in Sydney, Melbourne and Brisbane, will offer sustained benefits to the economy and society. They will dramatically change the way these cities function, influence where people live and work, and respond to current and forecasted population growth.

#### **The impact on project procurement**

While these are exciting times for the infrastructure market in Australia, such boom-time conditions are impacting government procurement agencies, requiring them to rethink their commercial and contracting strategies to avoid negative effects on pricing, risk management and project outcomes.

With so many projects underway, and more planned, contractors are forced to be increasingly selective about the projects they choose to take on. And, with a limited number of 'tier 1' and 'tier 2' construction firms willing or able to participate, many firms already have full order books and only a few have sufficient balance sheets to cover the volume of new projects.

This circumstance results in bidders becoming increasingly risk averse, pushing back on risk and procurement models and showing less appetite for aggressive pricing or program assumptions. From a government client perspective, the high volume of work also increases market pricing, due to competition for supply chain resources and limited

availability of specialist labor or equipment, especially when projects include local content requirements.

These constraints on the construction market can impact competition and value for projects, if not managed prudently. Already, a few high profile/high risk projects have seen only a single bidder, forcing a fundamental repackaging of the procurement model and risk allocation, to attract sufficient competition.

While population, economic and infrastructure construction growth are very desirable 'problems' to have, they require the government sector to carefully and regularly consult with the market, and use these consultations to fundamentally customize their procurement strategy before going to market.

#### **Smart strategies for boom times**

In light of the dynamic construction market, procurers must ask themselves, "How can we contract projects in a way that will attract a competitive field of bidders?" They must also ask, "How can we constrain costs and drive value for money, in a market in which there is a supply and demand imbalance?"

Based on our involvement with leading procuring agencies across Australia's largest projects, here are a number of advice points:

First, procuring agencies need to accept that the construction market is different than what they have seen in recent times. When there were fewer projects, clients could issue a large, complex, single package — on their preferred terms — and expect vibrant competition. The way they procured major projects last week, last year or five years ago are not relatable to next week, next month or likely, five years from now.

Second, clients need to maintain a deep and precise understanding of current market conditions. Market sounding is akin to 'dating' the construction market, trying to win their affection over all other projects in the market.

In turn, this means moving from pre-set and firm procurement and contracting strategies, in favor of customized contracting approaches that consider the widest possible packaging, procurement and risk allocation strategies. Then, they must test them repeatedly with the market.

What might have been possible through a single, multibillion dollar contract a year ago may need to be broken up and packaged by discipline, risk type or geographic or site location to meet current market capacities.

These changes in approach pose new challenges to government agencies, who will increasingly serve as sophisticated interface managers, aligning multiple packages and contracts to meet overall project objectives and deliverables. This means engaging new skills within government, backed with the right commercial, financial and project management expertise to support the agency.

And it means that they need to deepen and widen the range of procurement tools to de-risk projects to meet market conditions. An increase in flexible contracting models is likely, again posing management challenges to the government sector in the way it manages cost, scope and risk.

It also requires agencies to redouble efforts to answer wider legitimacy gaps or community concern over their respective projects. With a surfeit of choice about what projects to pursue, contractors are less likely to be attracted by projects that are exposed to political or sovereign-type risks.

Finally, a remarkable feature of the contemporary Australian infrastructure market is that, while construction is 'hot', infrastructure investment is 'not'.

For a range of reasons, the PPP (Public Private Partnerships) pipeline is subdued — and barring a few small vestigial transactions, the 'asset recycling' privatization pipeline is all but gone. This means agencies should also consider where PPP or other financed delivery options could apply. Each Australian 'tier one' contractor has a dedicated PPP team — backed by one of the worlds' most experienced and sophisticated infrastructure investment sectors.

For the 'right' projects, the relative desperation of infrastructure investment may help drive competition and focus from the tier one contractors, while providing accountabilities to manage cost, time and scope performance.

Ultimately, government agencies need highly skilled, experienced and integrated project procurement teams that live and breathe the market — and these teams need to be backed by a full suite of procurement models that are themselves adaptable and responsive.

## Advice for other jurisdictions

Few other developed markets are enjoying Australia's current problem of very high infrastructure activity, required to support strong and sustained economic and population growth. Nonetheless, the lessons and adjustments needed in Australia to meet current conditions apply equally to all markets — reflecting better practice in project delivery.

From the mid 1980s, Australia has been a world leader in infrastructure policy and procurement — and the country enjoys a deeply-skilled public sector, who understand the what, where, when and how of infrastructure project delivery.

Where they perform well, they have good systems, structures and procurement capabilities in state (provincial) treasury departments, line agencies and government owned corporations. Each with clear commercial principles and policies, and with procurement teams imbued with the authority to make project decisions.

When these are backed by a broader focus on governmental transparency, accountability and strong market and community engagement, Australia maintains public confidence and market momentum toward excellent projects.

Other countries can learn from Australia's experience in the government and private sectors are rich, diverse and positive, with more-than-30-years track record of delivering good projects, at excellent value to the economy and the taxpayer.

### Adopt smarter procurement strategies for shifting market conditions

To get large, complex projects right in any market cycle, procuring agencies should build flexible, agnostic delivery solutions:

- 1. Engage the market early:** Perform early, regular and strategic consultation with the construction market to learn their positions and challenges.
- 2. Develop bespoke packaging, procurement and risk allocation strategies,** based on the market feedback and reasonable expectations.
- 3. Consider leveraging financial sponsors:** Where appropriate, these sponsors may help spur competition and appetite from contractors.
- 4. Give the market confidence:** Communicate transparently and manage sovereign, political and community risks to boost market confidence in upcoming projects.

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