



Guidance for valuing COVID-19 project variation claims

Ministry of Education guidance for Capital Works and school-led property projects

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Project guidance

Introduction

This guidance is for internal and external school property project leads to use to help ensure a fair, equitable and consistent approach when valuing construction variation claims arising from the Government's response to COVID-19.

Since March 2020, the New Zealand construction sector has been dealing with the impacts of the ongoing COVID-19 pandemic. The Ministry of Education has created a process for main contractors and consultants to recover time and/or additional costs resulting from the pandemic. There are ongoing impacts and costs affecting construction projects. Material shortages and price increases that have the potential to delay and significantly increase school property project costs are becoming more prevalent. The Ministry's COVID-19 variation process is available to support all construction projects that are experiencing cost impacts relating to the ongoing COVID-19 situation.

In order to provide confidence and certainty to the construction sector, it is important that government agencies adopt a consistent approach. This guidance document was developed to help project teams working on Ministry projects review the legal and commercial issues associated with the pandemic. It applies to standard NZS 3910:2013 contracts and the Ministry's Medium and Minor works variants.

If you are unsure about how this guidance applies to any of your individual contracts, please seek further guidance by contacting COVID19Variations@education.govt.nz.

Purpose of this guidance

This general guidance sets out our expectations when valuing variation claims across school property projects. It is always subject to the specific terms of each project's contract. It is also based on information published at the time of preparation and is subject to New Zealand's unfolding economic and financial situation and alert level requirements.

There will be individual projects where specific complexities require greater analysis than provided in this guidance. Schools and their advisors should seek specific legal advice where more clarity is needed on an individual project.

We have been working closely with the Ministry of Business, Innovation and Employment (**MBIE**) and the Infrastructure Commission to develop this guidance and ensure it follows and supports the Government's position. We anticipate further valuation guidance for government agencies and will incorporate this into our guidance as it is developed.

Suspension of works by the Principal

For NZS 3910/3916 construction contracts, the instructions to suspend onsite works during COVID-19 Alert Level 4 were issued under either clause 6.7.3 as having become necessary or under clause 5.11.10 with reference to the Government's regulatory response to COVID-19.

Guidance from MBIE and the Construction Sector Accord records that cost increases, including any time-related costs, are to be treated as a variation and are recoverable by the contractor. This is because the suspension was not a result of contractors' default.

Ongoing impacts of COVID-19

Following the demobilisation and remobilisation of construction sites, there are several ongoing impacts affecting the construction sector and school property projects. The border closure is causing labour shortages and delays to offshore materials. The cost of international freight has increased significantly, and global material shortages are impacting prices and availability. To compound this, there are also a number of material shortages domestically, particularly structural timber.

Principles of managing COVID-19-related variation claims

We encourage following these principles when managing variation claims:

- Take an equitable, fair and reasonable approach in accordance with the guidance issued by MBIE.
- Principals are encouraged to be open and collaborative when discussing and agreeing on variation claims.
- Contractors are expected to act reasonably to mitigate costs throughout the process.
- Claims are encouraged to be submitted and processed by both parties as soon as practicable.

Principles of valuing COVID-19-related variation claims

We encourage following these principles when valuing variation claims:

- It will be the contractor's responsibility to prove, with evidence, incurred costs and we should encourage them to take an open-book approach to justifying costs.
- The majority of claims should be reviewed in a standard, consistent way.
- Submissions and responses should be completed in a transparent, open and collaborative way.
- Each claim should be assessed on its merit and treated equitably by adopting a fair and reasonable valuation of all costs.
- Double dipping will be strongly discouraged. If a labour wage subsidy has been claimed, it should be clearly shown and deducted from labour costs.

We expect that all parties, including engineers to contract, collaborate to agree variation values and reach an equitable outcome in the best interests of the project.

The risk of contractor, sub-contractor and supplier insolvency has significantly increased due to COVID-19. Industry and school property projects may be negatively impacted by these insolvencies.

We encourage all parties to treat members of their supply chains with respect and make efforts to minimise the effects of COVID-19 on them and their liquidity.

We encourage diligent record keeping. This includes the filing of correspondence, meeting minutes, timesheets, site photos and site visit reports. Key event timelines will also be important to enable robust and efficient claim assessments and engineer decisions.

Timing to submit variation claims under COVID-19

We expect parties to work together to ensure variation claims are submitted and processed as soon as practicable.

We acknowledge the uncertainties and complexities of the cost impacts of COVID-19 and that it will take time for contractors to calculate and substantiate all additional costs. The amount of time required will vary project by project and between contractors.

We expect some contractors to have multiple variation claims as additional costs are incurred.

Payment of variation claims under COVID-19

Subject to the terms of the applicable contract and any legislative requirements, we intend to process and make payment on variation claims as soon as practical after receiving a claim. As claims are assessed, further information may be sought on some cost items. We will work with contractors to make sure that, whenever possible, accepted claims are paid and not delayed by additional analysis required of more complex cost items.

Items which may be included in contractor claims

There are a range of scenarios that may occur on a project as a direct or indirect result of COVID-19. The table below outlines some potential claims we may receive.

Type of claim	Risk title	Likely project variations	Calculating cost	Guidance notes
Delays				
Delays	Extensions of Time (EOT)	The overall effect on project programmes as a result of the impact of direct and in-direct delays on the critical path, guidance specific to likely instances outlined below.	EOT Claims	Fair and reasonable assessment of time lost in line with principles outlined
Material risks/delivery etc.				
Materials	Material cost increases	Impact of COVID-19 on material availability leading to cost increases from merchants, alternative sourcing of materials to meet programme requirements, applicable to all materials	Difference between tendered costs and actual	Must be evidenced
	Storage	Impact of COVID-19 on material delivery, resulting in off-site storage	Extra storage costs	Must be evidenced
Labour issues				
Labour	Labour shortages	Increase in subcontractor labour costs for projects in flight, re-negotiation	Difference between tendered costs and actual	Must be evidenced
	Sub-contractor insolvency	Increase in pricing when procuring alternative subcontractors to pick up current works	Direct increase in sub-contractor costs	Must be demonstrated and evidenced
	Productivity reduced	Loss of productivity of site trade operations (indirect costs)	Reasonable valuation of increased costs	There is an expected productivity drop due to working restrictions associated with Alert Level 3 and Alert Level 2 requirements. Reasonable evidence should be provided.
		Increase of health and safety requirements	Reasonable valuation of increased costs health and safety and associated items	Issues such as developing cleaning regimes/extra costs for cleaning materials/working practices, etc.

Labour issues (continued)				
Labour (continued)	Productivity reduced	Organising materials to site	Possible associated delays and increases in material transport costs due to high demand	
		Shortage in labour	Associated delays in re-establishing workforce on site	Evidenced by site documentation showing operative numbers and hours (before and after lockdown)
		Indirect delays on critical path, downstream EOT claims	EOT claims	Reference to programme and critical path
Site works				
Logistics	De-mobilisation following Alert Level 4 announcement	Demobilisation of projects under time constraints	Reasonable valuation of increased costs	Must be evidenced
		High demand for off hires resulting in increased transport and other associated costs	Claim for off hire costs at short notice	Must be evidenced
		Extra labour required to shut down sites	Increase in personnel on site and potential loss of productivity in other work areas	Work on sites must stop following an Alert Level 4 announcement. Some labour may be used for lockdown protection works.
		Purchase and installation of protection measures	Associated material costs and transport costs due to high demand	Must be evidenced
	Re-mobilisation following Alert Level 3 announcement	Remobilisation	Reasonable valuation of re-start costs (including labour) and costs to implement COVID-19 Alert Level 3 operating requirements	Must be evidenced
		Plant and site items back on site, increase in transport costs and delays	Reasonable claim for on-hire costs	Must be evidenced

Site works (continued)				
Defects	Damage to buildings during suspension of works	Remedying defects from water damage, internal fit out, building structure/fabric and site works	All reasonable costs associated with remedying any defects	With due consideration to the reasonable mitigation steps taken at the time of the lockdown and the short time available to make sites secure. Note: There may be insurance cover for some of these items.
		Damage resulting from vandalism	All reasonable associated costs with rectifying damage	
		Disposal and replacement of damaged materials currently stored on site	Disposal and replacement of projects materials	
		Other damage/theft related to sites/buildings	All reasonable costs associated with remedying any defects	
Plant, equipment and access				
Plant, equipment and access	Hire costs for temporary equipment during suspension of works	Costs over and above tender for site plant and equipment – time related hire costs and any protection, scaffolding/cabins	Hire costs and other costs for plant items which are not reasonably included in tender.	Contractors should off-hire larger plant items on site but with time constraints this may not be possible, all site protection and welfare items should remain on site – and will be subject to a hire charge.
		Delays due to re-establishing and hiring plant/equipment	EOT claims and increase in transport costs due to high demand	Must be evidenced
		Costs for plant that was unable to be off hired	Hire costs for plant items kept on site	A potential benefit of these items being kept on-hire could mean an increase in return to full productivity on site
Programme				
Programme	Delays - end dates missed	EOT Claims	Claims for time lost	Refer to Delays above
Processing Costs				
Processing cost	Variation processing cost	Time and administrative cost for compiling and processing the variation claim	Percentage as per contract or reasonable evidenced cost	Note that the Special Conditions within Ministry and Schools Major Works contracts exclude the contractor's right to claim for the cost of processing variation claims.

Discussion of types of claims

Delays

The suspension of contract works will create delay. MBIE guidelines say that suspension entitles contractors to a variation to claim time-related and additional costs.

Under most contracts this will be an assessment of the cost for on-site overheads.

Under many contracts a Working Day Rate (**WDR**) may have been agreed. The Working Day Rate is defined under clause 9.3.11(a) and 'shall be deemed to provide for time-related on-site overheads and off-site overheads and profit'.

On-site overheads are the cost of the general establishing and running of the site. This includes accommodation and offices, welfare facilities, supervision of the work and other non-building related costs such as insurances, inspections, health and safety, etc.

Where the contract contains a WDR it shall, where it is equitable to do so, be used for the purposes of calculating time-related on-site overheads and off-site overheads and profit.

Where it is inequitable to use the WDR or the contract does not contain a WDR, then a 'reasonable' WDR can be used.

However, note that this cost includes off-site overheads and profit. Therefore, it is recommended that the use and calculation of the WDR be checked to see what is included in the cost and that its use is equitable in the circumstances. Often a simple calculation that divides the P&G cost by the total project working days can be useful in identifying the 'average WDR'. However, a more equitable approach for some projects will be to identify and agree actual incurred on-site overheads and then agree a suitable allowance for 'off site overheads' including profit.

Actual costs should be substantiated by the Contractor on an open-book basis.

It is also important to note that variation claims may include allowances for on-site and off-site overheads and profit – usually in the form of a percentage applied to the net cost of the variation. Where these percentages are applied – it is important to make sure that double recovery (double-dipping) does not occur. This is because the percentage addition for on-site overheads is a recovery of time related cost. So, if the WDR has been used then recovery of on-site costs is deemed to have been made.

Items that typically would be included as on-site overheads would be:

- Remuneration and expenses for management, administration, routine staff, and supervisory staff associated with the running of the site (excluding working foremen and leading hands) – the rates should be established on the actual costs for the staff including kiwi saver contributions, annual leave provisions, statutory holidays, sick leave, ACC levies and insurances, fringe benefits, clothing and other allowances. **Note that any Government wage subsidy should be offset / deducted from these actual costs claimed as a variation;**
- Insurance premiums / bond extensions;
- Site and temporary works and facilities – such as hire of office cabins, shelters, canteens, ablutions and toilets, security fencing, alarms (if applicable), scaffolding, craneage and other heavy plant; office equipment and communications; and
- There may also be other costs such as power and services running costs.

Off-site overhead and profit recovery should be demonstrated to ensure an equitable outcome. Amounts claimed should demonstrate that these off-site costs (for general running costs for the contractor's business – administrative, financial and overhead costs for head office, and other off-site overheads dedicated to the contract) are apportioned correctly. This should be reviewed against the percentages identified within the contract.

Off-site recovery will need to adopt a common-sense and equitable approach making reference to stated rates in the tender or other relevant information.

For clarity, a claim for profit margin within a WDR is anticipated by most NZS-based construction contracts and is considered reasonable. This is not a claim for 'loss of profit' or 'loss of opportunity' which is not considered as reasonable in Ministry contracts.

Material risks/delivery

Lack of materials: Material shortages could require finding alternative supply chains, which may come at a higher cost. There may also be an increased cost for international freight, domestic haulage and delivery and foreign exchange rates.

Material supply program delays: Material supply issues may cause delays to projects, which will need to be reviewed against the programme and the critical path. This could lead to a further extension of time claim.

Storage costs: There may be materials located at ports and other facilities that could not be delivered to sites, justifying a claim for additional storage costs. Main contractors may have ordered materials early to avoid delays and require additional storage for materials.

Labour issues

Health and safety costs under alert levels: Under Alert Level 3 and Alert Level 2 'distancing and separation requirements' are required to minimise transference of COVID-19.

Expect additional costs implications arising from:

- SSSP updates – site specific safety plans and requirements will need to be updated and communicated to site workers
- Additional health and safety requirements – distancing and separation
- PPE – masks / gloves / welfare facility, etc
- Welfare facilities – alteration of site facilities to increase separation
- Cleaning regimes
- Access routes and separation
- General loss of productivity around number of staff and working area restrictions

This type of productivity cost is calculated based upon comparing non-productive allowances that are built into rates. Contractors will need to demonstrate the impact of the safety requirements upon the normal expected productive time during the working day.

Labour costs: COVID-19 wage subsidies need to be considered and deducted from any costs submitted to ensure the no double dipping principle is upheld.

Additionally, staff pay rate deductions should also be taken into consideration. In parts of the industry, reduction in basic salaries has been implemented by some companies to reduce cashflow exposure. An open-book approach is encouraged to demonstrate collaborative and equitable reviews.

Site works

The instructions to suspend onsite works during COVID-19 Alert Level 4 requires contractors to secure sites on short notice. There will be costs associated with this process. The Ministry has previously confirmed its coverage of reasonable costs to secure sites. These costs should be relatively easy to identify and agree, based upon presentation of invoices for materials and timesheets/site diaries for operatives.

As part of the process we request photographic evidence to be provided of the status of work and measures taken at the time of the suspension of works. Evidence should be supplied with claims and will further assist the cost evaluation.

Defects

Re-work: There is risk that reasonable preventative measures and protections put in place at the time of suspension of works may not be adequate to prevent damage during the suspension period caused by:

- Weather – wind and rain
- Vandalism
- Graffiti
- Services – pipe bursts etc

It is our expectation that damage and defects will be covered if reasonable preventative measures were carried out by contractors. However, entitlement should not be automatic, and the steps taken to secure and make safe sites should be assessed. Additional costs covered may include the removal and replacement of some damaged components or elements. It is recommended that photographic records of these defects be requested from contractors at the time of site re-establishment, before the materials are removed.

Rates and costs for removal and replacement should be established – preferably prior to the works being instructed.

Plant and equipment

There are likely to be plant and equipment costs incurred during suspensions of work. Some contractors will manage to off-hire and remove loose plant and equipment from sites prior to the suspension, but others particularly in remote areas or where it is demonstrated to be impractical may not be able to do this.

Items such as scaffolding, cabins, site security fencing and other semi-fixed temporary plant is likely to be left on site. This is likely to incur hire charges.

Where there are plant hire costs, for hire of scaffold and other plant left on site during the suspension the costs will need to be demonstrated by the contractor. It is also recommended to check that these are not covered by the WDR (noting that this is unlikely as scaffolding is becoming more traditionally regarded as a trade and not an on-site overhead or set up cost).

Demobilisation: There may be costs incurred from securing the site and making it safe. This may include off-hire costs and charges, making safe costs, etc.

Remobilisation: These may be costs arising from recommencing site works, and compliance with the COVID-19 Alert Level 3 operating requirements. These may include labour costs and the delivery of plant/equipment back to the site.

Additional plant hire: Costs for hire of scaffold and other plant/equipment left on site during suspension.

Programme risks

The main risks arising from the suspension of works and associated costs are covered under the Delays section. Further delays may be caused by a slow re-mobilisation during Alert Level 3 and Alert Level 2 stages.

There may be ongoing additional risks of delays caused by shortages of labour and materials.

To help proactively identify these risks and potential costs we recommend that these risks are discussed during PCG meetings. The purpose is to identify risks that the project now faces. The origin of those risks should be from the contractor but there should also be consideration of risks from the Ministry and/or school. This is an opportunity to work collaboratively with contractors to review potential labour and material supply threats. Careful consideration should also be given to appropriate cost mitigation options that could be implemented by contractors.

The approved contract programme should be reviewed and updated before and after the meeting as this is an essential document to assess the anticipated time-related claims.

Excluded claims

Claims for the following will not be accepted;

- Working from home setup costs
- Business continuity costs during the Alert Level 4 period
- Materials off-site payments outside of the terms of the contract
- Loss of profit and /or loss of opportunity

Appendix 1. Valuing variations by Ministry Standard Contract type.

Construction Contracts

3910 / 3916 Major Works Contracts

1. Section 9 of NZS 3910/3916 deals with variations and how they are valued. Our Special Conditions amend some of the standard provisions in Section 9. To understand how the contracts deal with variations, it is necessary to read the standard NZS provisions alongside our relevant Special Conditions.
2. Below is a high-level summary of some of the key points to note in relation to how variations are valued under our NZS 3910/16 Major Works contracts. To be clear, this is only a summary and provides some high-level guidance. It should not be used in lieu of reading the relevant terms of each contract, including tags.
3. The following are the key points to note under 9.3 in terms of valuing variations:
 - The engineer is primarily responsible for assessing/agreeing the value of a variation (i.e. not us as principal).
 - The value of variations should be by agreement where possible.
 - Where agreement can't be reached, the balance of the provisions in 9.3 are applied by the engineer.
 - Project leads should confirm to engineers our agreement to cover the cost of all reasonable works incurred to protect the site.
4. The provisions for valuing variations are complex, and often project specific (e.g. some but not all projects will include a complete schedule of prices etc.). The relevant provisions are worked through in sequence until the appropriate method for the project is identified. We cannot apply a blanket direction across all projects. We will be relying on the expertise and experience of its engineers in respect of their assessment for each specific project. While we acknowledge that the unique circumstances of the COVID-19 pandemic may pose some challenges for engineers (and contractors), it will be for the engineer, in the first instance, to work through the process.
5. If agreement can't be reached, and the engineer therefore sets the value, both parties, us and the contractor, have a right to dispute the determined value within three months of it being provided.
6. We expect most Major Works variations to be agreed and recorded by an engineer's determination (covering any changes to scope, costs and programme). If matters get complex, or you are wanting to record a change in actual contract terms, then a more formal deed of variation prepared by Legal will be required.
7. Note that, at the most basic level, the objective of clause 9.3 is to fairly compensate a contractor for the impact of the variation on the contractor's costs (in this case the impact of the COVID-19 lockdown).

Medium Works Contract

1. The provisions for valuing variations in our Medium Works contract are much less prescriptive than those in its Major Works contract. Clause 4 of the Medium Works contract provides that:
 - the parties should, where possible, agree the value of variations; and
 - in the absence of agreement, we shall set the value by reference to the schedule of prices (if any), the Contractor's prices for similar work (if any) and, perhaps most relevantly for present purposes, '...what is fair and reasonable in the circumstances.' With no engineer in our Medium Works contract, the responsibility for agreeing the value of variations, and ultimately setting the value, if not agreed, will sit with project leads. We expect most of these variations (covering any changes to scope, costs and programme) to be agreed in a clear exchange of emails between the parties. If matters get complex, or you are wanting to record a change in actual contract terms, then a more formal deed of variation prepared by Legal will be required.
2. It is difficult at this stage to predict all the costs a contractor may be entitled to claim, but we encourage you to bear in mind our early agreement to cover the cost of all reasonable works incurred to protect the site and the key objective of the variation provisions to fairly compensate a contractor for the impact of COVID-19.

Minor Works Contract

1. The provisions for valuing variations in Ministry Minor Works contracts effectively mirror those in the Medium Works contract. In short, clause 4.2 of the Minor Works contract provides that:
 - the parties should, where possible, agree the value of variations; and
 - in the absence of agreement, we determine the value by '*...what is fair and reasonable in the circumstances.*' Again, with no engineer in the Minor Works contract, the responsibility for agreeing the value of variations, and ultimately setting the value, if not agreed, will sit with the project lead. Agreement should be recorded in a clear exchange of emails.
2. As with Medium Works, we encourage you to bear in mind our early agreement to cover the cost of all reasonable works incurred to protect the site and the key objective of the variation provisions to fairly compensate a contractor for the impact of COVID-19.



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