

ACHIEVING BEST VALUE IN SOCIAL HOUSING PROCUREMENT

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This research into the effectiveness of ‘best value’ procurement in the social housing sector analyses and critiques current procurement methods and assesses the potential ramifications of legal challenges to the strategic management of the best value process. The overarching aim of the research is to produce a contractor selection method that is; mathematically robust, transparent, open to audit and assists the user in the selection procedure. To date, the research indicates that the inherent problem with best value selection is that the measurement of quality is a subjective process and can therefore be defined and interpreted in numerous ways. In order to formalise a more appropriate measurement system, two case studies were carried out, to assess the pragmatic difficulties being encountered by stakeholders within the social housing sector. The conclusions of this research has laid the foundations to further ongoing research into the formation of an innovative best value contractor selection process based on the mathematical representation of rational preference, with the decision maker’s attitude to the uncertainty factor in the selection process being represented by a utility function. When refined, it is anticipated that the model will be generic enough to add value to any construction procurement process within the social housing sector.

Key Words: Best value, Law, Procurement, Social Housing, Subjective Measurement.

INTRODUCTION

Changing world markets, coupled with the introduction of new technology and a rise in clients expectations have put construction practices and processes under scrutiny and have stimulated reviews of how the industry delivers value. Within the UK this global concept of revaluing construction has been applied to many sub-sectors of the industry, particularly public sector projects. This research focuses on the effect that the implementation of the processes of best value and partnering has had on the structure and operation of the social housing sector. This sector is responsible for a programme of construction, maintenance and refurbishment works, which is annually valued at £1 billion GBP (DTI 2003).

Social Housing provision within the UK operates under the umbrella control of two main arms, the first being the housing provided and managed by Local Authorities (commonly called council housing) and the second being the housing provided and managed by Housing Associations and other organisations, which together form the

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“voluntary housing movement”. The welfare of these housing associations falls under the umbrella control of the Housing Corporation, which is a central government financed quango formed under the 1964 Housing Act to promote and assist the development of housing associations. The Housing Corporation has the powers to provide loans to housing associations for development schemes and most associations have received such a subsidy (Stewart 1996). There is no typical profile for the housing stock of these two providers, as social housing is provided in a variety of building styles and in a huge range of locations (Harriott and Matthews 1998). The term “registered social housing landlord” (RSL’s) is used as a collective term for both housing associations and local authorities alike as providers of social housing.

Two features that the majority of RSL’s share is that (a) they are regular procuring clients to the construction industry and (b) their corporate strategy and operational procedure is shaped and regulated by Government policy which has allowed these organisations to be used as key drivers for the behaviour of the UK Construction Industry. This statement is underpinned by the fact that, whilst the reports commissioned by the UK Government to review this country’s tendering processes (such as the Simon Committee report (1944) and the Banwell Committee report (1964)) have concluded with an overarching call for better value in the procurement of construction, it wasn’t until similar reports produced under the leadership of Sir Michael Latham (Constructing the Team, 1994) and Sir John Egan (Rethinking Construction, 1998) that client organisations were suggested as spearheading such a drive. This demands a paradigmatic shift in the structure of the industry away from traditional practices and a move towards collaborative working and selective competition.

The philosophy that the introduction of the desired cultural change towards integrated teams and long term supply chains should be client led has, since the Egan Report, been restated by a plethora of subsequent reports and guidance notes published by: the Government (Modernising Construction 2001, The Achieving Excellence suite of briefings 2003), its quango’s such as the Housing Corporation (Partnering through the ADP 2003) and the Strategic Forum for Construction (Accelerating Change 2002). As a direct result of the Egan Report more than four hundred demonstration projects were put forward by the construction industry (Jones et al 2003) to illustrate the success of the new philosophy of lean thinking throughout the integrated supply chain, including the implementation of management measurement techniques such as benchmarking, and key performance indicators which were used by the construction industry for the first time.

However it is important to note that whilst partnering and best value procurement has been embraced by both the private and public sector it’s adoption by the Social Housing Sector can be attributed to political influence and the redrafting of legislation rather than a genuine desire to change which has been culturally driven by the internal corporate policy of the individual RSL’s. Historically, there is an acknowledged problem with large public sector organisations embracing change (Thomas Cain 2003) and there is no reason why the cultural sea change required to implement collaborative working and value for money procurement should have been received any differently by the public sector. The best value regime was introduced at a local government level by way of new legislation on the 1st April 2000; it applies to all public services controlled by local authorities and requires local councils to review, develop and to show continuous improvement with respect to their procurement strategies in terms of their efficiency, effectiveness and economy. Though in a global sense it may be

difficult to provide a universal definition of the term “best value” (Choi 1999) the UK Government defined best value as “The optimum combination of whole life cost and quality to meet the user’s requirements. Long term value over the life of the asset is a much more reliable indicator than lowest cost and it is the relationship between long term costs and the benefit achieved by clients that represents value for money” (Office of Government Commerce 2003). It is this definition of best value that is to be used to underpin the production of the proposed contractor selection model.

In August 2000 the Housing Corporation also showed its commitment to the use of partnering in the procurements process “provided it [partnering] is implemented in a well-planned way that clearly demonstrates value for money and addresses the issue of probity.”(Housing Corporation 2000). The Housing Corporation went on to endorse partnering as a way to “introduce the cultural and procedural changes necessary to better enable Registered Social Landlords wishing to embrace the principles contained in the Governments Task Force *Rethinking Construction*” (Housing Corporation 2000). By 2003 the Corporations expectations were that “all registered social landlords’ construction activity is to be Egan Compliant and they will only provide funding for registered social landlords that have achieved Client’s Charter Status. The Charter identifies the culture change that is required for a client organisation to effectively follow *Rethinking Construction* principles” (Housing Corporation 2003). In other words, unless an RSL under the umbrella control of the Housing Corporation can demonstrate that it implements its procurement process in compliance with the ethos of collaborative working and value for money objectives, it will not receive grant monies to carry out the required works. Although it would be naïve to believe that RSL’s (and their approved contractors) have made the necessary cultural change for any other reason than to secure future funding for their construction activity, the fact is that RSL’s have been faced with a *fait accompli* with regard to their implementation of collaborative working and best value tendering

This enforced change in process has been monitored and assessed by a number of organisations specifically created for the purpose. In the social housing sector this task has been carried out by The Housing Forum, the Local Government Task Force and the Central Government Task Force. These bodies have reported back on the success of this paradigm shift in the work processes of the industry and that the predicted benefits of collaborative working in terms of cost savings, reduction in time and reduced waste production (Reading Construction Forum 2001) are all being met. However it is also apparent that problems exists with best value and partnering which have caused certain RSL’s to incur financial losses. This forms one of the main drivers behind this research and led to the generation of the initial hypothesis that contrary to the published data, the implementation of collaborative working has not been a complete success and that the cultural and procedural changes applied to RSL’s has lead to a lack of understanding of the best value tender process. This is likely to have led to financial loss in some cases.

CURRENT BEST VALUE TENDER MECHANISMS

A review was undertaken of the existing literature relating to best value procurement encompassing research papers, technical documents and law reports to ascertain the shortcomings with existing contractor selection and tender analysis mechanisms. There have been a number of academic studies researching the criteria to be used for contractor selection and it has been argued that there exists a need to clarify and develop pre determined selection criteria, to improve and organise the assessment of

the information relating to these criteria and to develop methods for evaluating the criteria against the clients goals in the pre-qualification and bid-evaluation stages of the procurement process (Holt 1995, Holt *et al* 1996 Hatush and Skitmore 1997 & 1998)). Though these studies were not directly focused upon best value, the detailed findings of a subsequent project set out a number of factors that were causing construction practitioners difficulties during best value tender evaluation with respect to design and build contracts (Griffith *et al* 2003):

- Insufficient time to conduct a relatively standard tender evaluation process.
- The Clients value system needs to be made explicit.
- Contractors have a negative perception that the best value tender interview is a game of appearance and marketing skills.
- Costs should ideally be considered on a whole life basis and not simply capital cost.

The underlying problem identified by this research is that though it is understood by RSL's and contractors alike that any particular schemes objectives must be translated into a contractor's tender proposal which addresses factors of both "price" and "quality", there is a lack of pragmatic knowledge as to how this should be achieved and still produce a transparent audit trail for the process as required by the Audit Commission (HM Treasury Guidance Note No 4). This problem area is also illustrated by the research undertaken by The British Practice in Partnering Group (BpiPG) "Best Practice in Partnering: Development of Guidance on Professional Practice in Partnering for Registered Social Landlords" (Jones and O'Brien 2003). The published report highlights the fact that though RSL's understand the principle of best value tender selection with respect to establishing the hierarchy of value of each individual criteria assessed and that they also understand the importance of weighting the attributes with respect to their relative importance to the clients value scheme there is an underlying mathematical weakness within the tender mechanisms that can be manipulated by contractors (if they choose to do so) so that they can inflate the cost of the works and still be awarded the contract by virtue of the evaluation of their tender submission regarding the quality attributes.

LEGAL CHALLENGES

The best value concept has already been challenged in the UK court system with the most well known case being *Harmon CFEM Facades (UK) Ltd v The Corporate Officer of the House of Commons* in which the Court of Appeal held that the phrase "overall value for money" was both nebulous and imprecise and made the judgement that where the term "best value" or "value for money" is not specifically defined or recorded then the contract should be awarded on the basis of the lowest bid. In this instance the contractor, Harmon CFEM Facades, was awarded £7.4 million pounds in damages, to be paid by the client, as they had supplied the lowest bid but hadn't been awarded the contract works.

There is also an intrinsic conflict of values between the underlying ethos of collaborative working and the contractual obligations of the standard forms of construction contracts. The principles of partnering have been defined as "choosing to live by the spirit [of the law] rather than the letter of the law, values that are treasured in an ethical democratic society" (Baden Hellard 1995), but even if this philosophy

were to be enshrined within a partnering charter agreement it may not be binding nor conjunctive with the main contract (Jones *et al* 2003). The ramifications of this for best value procurement in the social housing sector are that measurements of the subjective components of value (Kelly *et al* 2004) must be capable of withstanding audit scrutiny because whilst a client may accept a contractor's bid and justify it on the basis of "good faith" (or that the contractor may "add value" to the contract) this may conflict with the terms and conditions of the contract and if challenged in the courts, potentially, the law of contract will be favoured over any general doctrine of good faith. There are a number of deep-rooted objections to the concept of good faith in UK law, not least, that good faith provides a standard, which is vague at best and invites lawyers and judges to debate moral arguments that are subjective and irrelevant for legal purposes. (Jones *et al* 2003). The very real issue that needs to be addressed within both best value and partnering contracts is the quantification of loss should a dispute arise in connection with a "failure of the parties to collaborate" or a failure of one party to achieve "a subjective quality target". It will be difficult to define the loss that flows from such failures and probably even more difficult to measure it.

THE AIM AND OBJECTIVES OF THE RESEARCH.

The research has clearly demonstrated that there are deficiencies with the existing best value tender mechanisms that, potentially, leave them open to manipulation by contractors, which may result in financial loss for the RSL's. There is a need to formulate an innovative generic contractor selection mechanism that is: (i) Transparent; (ii) Open to, and able to withstand, a third party audit process; (iii) the client's value system is clearly stated; (iv) Assesses both the subjective and objective component of value; (v) Mathematically robust; and (vi) Assists the user group in the selection procedure.

METHODOLOGY.

Prior to the development of the contractor selection framework further research was necessary, as the intrinsic problem identified during the review was that there was a lack of pragmatic and detailed guidance provided to, or developed by, RSL's as to how they should undertake a best value tender analysis. There was a need to gain more in-depth knowledge as to the problems being encountered by RSL's and two descriptive case studies were undertaken of RSL's that were involved in a dispute resolution process due to anomalies around their partnering and best value tendering procedures. The case studies were based on a typology design (Yin 1993) and both identified the best value process undertaken by the RSL's and recorded the consequences of their procedural actions. It is intended that these two initial studies will be part of an ongoing development of a case study database in order to enhance the validity and reliability of the findings. (Fellows and Liu 2003).

CASE STUDIES

The first case study was a housing company that had been formed from a stock transfer of Local Authority dwellings, whilst the second was of a housing department within a London Borough Council. The circumstances involved in the case studies replicated each other in so far as both of the RSL's had undertaken multi million pound refurbishment and repair contracts to designated estates within their respective housing stocks and had engaged the successful contractor by undertaking a best value tender assessment. The costs of the works were subsequently challenged by

stakeholder organisations with respect to each of the RSL's. In both instances the challenges were initiated by residents of the estates who had purchased their dwellings under Right to Buy legislation and disputed the RSL's right to recover part of the cost of the works via the service charge recovery mechanism within the leases.

Case Study 1:

The RSL was formed in 1999 as a result of a partial stock transfer from the Local Authority. They were provided with £46m of Central Government funding to undertake regeneration works to their portfolio over a five-year period. The RSL allocated £7m to carry out refurbishment to one specific residential estate comprising eleven blocks of flats. The contractor was appointed by the board of the RSL on the basis that (a) the price negotiated represented good value for money and (b) the partnering arrangement would provide beneficial returns through repetition of work leading to increased efficiency and improved quality. The stakeholder group representing the residents of the estate argued that they should not have to contribute to the cost of the works as the best value tender process had been carried out in an unreasonable way. The dispute was referred to arbitration and the arbitrator held in favour of the residents due to the fact that the RSL could not provide any credible evidence to show that the contractor had been engaged on the basis of a best value tender nor could they provide an audit trail to support and underpin their reasons for selecting the contractor on both a price and quality basis.

Case Study No 2.

The RSL (the housing department of a London borough council) engaged a contractor to undertake an over cladding contract of two 1960's built concrete framed tower blocks of flats using an insulated cladding system. The tender for the works contract was carried out on a selective competitive basis and the contractors submissions were analysed using a best value tender mechanism devised by the Construction Industry Research and Information Association (CIRIA 1998) which is based on a multi attribute analysis approach and is concerned primarily with selecting the contractor based on their ability to add value to the overall project. As in the previous case study a stakeholder group representing the residents challenged this process as unreasonable and the dispute was referred to arbitration. The arbitrator found in favour of the residents on a number of grounds including the fact that the RSL had not acted in a reasonable manner during the contractor selection process because (a) the tender sum had not been benchmarked against other similar projects and (b) price /quality ratio within the CIRIA framework can be manipulated to allow the contractor to inflate the price and yet still be the successful tenderer by scoring highly on the quality factors.

DISCUSSION.

The literature search and case studies demonstrate that there is a commonality in the problem areas that have been identified by; academic researchers, the legal system and construction practitioners regarding the introduction of best value procurement into the public sector. Manifestly there is a lack of understanding as to the definition of the term "best value" and a general perception that a number of RSL's and their consultants are unable to provide clear audit trails as to the processes involved in their best value tender assessments. This lack of transparency has affected their ability to recover monies owed to them from some stakeholder groups within their project supply chains and may, potentially, lead to disputes with contractors once the "best value honeymoon period" is over. The importance of a RSL's procurement process

being both transparent and auditable cannot be underestimated as they enjoy less freedom of choice than their private sector counterparts due to the constraints and restrictions placed upon their operational policy by the Housing Corporation and Audit Commission. When selecting a best value proposal the RSL's should carefully balance the procurement objectives and value for money criteria within the need to comply with public procurement principles and governing rules/regulations in a public accountability framework (Palaneeswaran *et al* 2003). Part of their inability to form audit trails lies with the fact that there are two components to value, one is an objective component such as cost or price but also there is a subjective component for value that is more difficult to define explicitly. (Kelly, Male & Graham 2004). Manifestly the measurement of the objective component is relatively straightforward in that monetary units are an instantly recognisable means of comparing two objective value attributes, (though it is worth noting that lack of a clear benchmarking process caused a problem within case study 2). However the measurement of subjective value component is inherently difficult to record and quantify because, in reality, it is a measurement of the thought process and preferences of the individuals involved in the tender evaluation mechanism. It is the lack of clarity in both defining and then subsequently assessing the subjective components of value that has led to RSL's failing to comply with audit trail requirements. Further research is currently being undertaken by means of a questionnaire sent to stakeholder groups within the social housing sector supply chain and factor analysis of the data collected to establish generic characteristics within RSL best value contractor selection frameworks which should provide clarity and a degree of standardisation of the best value tender analysis process.

CONCLUSIONS

The key drivers for the adoption of partnering and best value procurement by the Social Housing Sector can be attributed to political influence and the redrafting of legislation rather than a genuine desire by a RSL to culturally change. Though there have been numerous demonstration projects reported that illustrate the success of this paradigm shift in the culture of the construction industry the research has shown that, in reality, RSL's have been ill prepared to deal with certain aspects of the change process which has led (or will lead) to financial loss. Many of the difficulties encountered by the RSL's were either due to a lack of understanding of the best value process or because the RSL's could not comply with the public sector requirement for accountability. The research showed that there is a need to provide RSL's with clear guidance as to how to implement and record a best value tender process, which transparently details the clients corporate value system relevant to each project proposal and that it is essential that the analysis of the contractor's tender returns is conducted in a rigorous and transparent manner. There is a general lack of understanding as to the operation of best value tender analysis mechanisms currently in use and this fact in conjunction with an inherent lack of mathematical robustness has exposed these price/quality analysis frameworks to manipulation by contractors. The next stage of this ongoing research is to establish generic criteria and standard factors that can be incorporated within a RSL's (and their stakeholders) value system and determine a method of measuring and recording the subjective components of value that is based on utility function rather than monetary units. In this way the subjective measurement process can both reflect the preferences and choices made by the RSL during the multi attribute tender analysis procedure and comply with the need for transparent accountability within the social housing sector. .

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