ARE YOU USING THE RIGHT INDEX? MANAGING INFLATIONARY RISK ON CONSTRUCTION PROJECTS

June 2023

On 7th June 2023 BCIS hosted a webinar entitled 'Are you using the right index? Managing inflationary risk on construction projects.' During the webinar attendees had the opportunity to submit questions, here's a round-up of some of the questions the panel were unable to answer on the webinar.

Q: Can you please explain about how to correctly use indexation when fixed price periods have expired? Do you index back to when the subcontractor originally priced the job or from when the fixed price period ended?

A: It depends. One approach would be to index link from the intended mid-point to the actual mid-point, it would depend on the contract. On maintenance contracts that are fixed for a year the normal practice would be to index from the base date to the anniversary.

Q: I would be interested to hear BCIS' opinion on a lawyer's decision to use CPI as a benchmark for assessing construction inflation enabling a contractor to claim costs above a CPI baseline set of 8%.

A: This sounds like cost plus with a threshold, it limits the client's exposure to construction cost inflation above general inflation. Find more information about using a construction-specific index rather than CPI here.

Q: Not construction directly, but what would be the most appropriate index for NEC4 Professional Services Contract Option X1?

A: 4/CE/03 Professional Services - see notes and definitions on the BCIS service.

Q: On the "all in TPI", the future dates (2024 etc) are labelled as "Forecast" which I understand. But why are all historic indices labelled "Provisional" rather than "Firm" ?

A: The provisional status indicates that the index is based on the BCIS TPI Panel. Pre-COVID that was intended to last for approximately one quarter until project and modelled data could replace it but lack of data prevented this and for the last three years the index has been purely based on the TPI Panel. The intention is to re-introduce the hybrid approach which will cause some revisions.

Q: How to use the base date for variations?

A: This depends on what the contract says but it would seem sensible to use the date at which the substitute work was priced.

Q: For indices that have provisional figures, how are these provisional figures generally calculated or arrived at before becoming firm?

A: For PAFI, these are generally based on PPIs from ONS. ONS holds the PPIs provisional while survey responses continue to come in - so the firm index will be based on a more robust sample than the provisional index. Similar considerations affect indices where BCIS collects the source data.

Q: What is the recommended split in terms of inflationary risk, 50/50?

A: BCIS cannot provide a recommendation, it depends on the intention of the parties. A non-adjustable element (NAE) of 0% would theoretically give the best price but may not suit every client. Based on projects back to the 1980s from the BCIS database the most common percentage for NAE was 10% followed by 5% and 15%.

Q: If the inflation is rapid how often should we prepare? Is there any template?

A: There is no template. This depends on the contract and the index. PAFI indices are updated monthly and most construction contracts allow for monthly valuation.

Q: All in Tender Price Index often seems low in terms of all in % uplift when you hear about industry increases in materials etc. How is the All-in forecast generated?

A: Since 2020 the BCIS All-in TPI has relied on the TPI Panel's estimate of quarterly tender price inflation. While materials and/or labour prices are an important influence on tender prices, supply and demand effects can dominate so tender prices will not always follow costs in the short term.