

Are we overpaying PDPs?
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The growing role and enormous fees of PDPs in the nation's transportation projects such as the MRT and LRT are prompting questions of cost effectiveness and transparency.

Are project delivery partners (PDPs) getting paid too much for, what is in essence, a supervisory job?

The 6% management fee of PDPs works out to hundreds of millions, more often billions. While the scale and complexity of these transportation are undeniably huge and companies such as MMC and Gamuda have so far delivered, forking out a similar amount to a relative unknown such as George Kent is worrying many industry observers.

Is the government getting the best bang for the rakyat's ringgit by going down the PDP road?

In 2012, shortly after MMC-Gamuda was named as the PDP for the first phase of the Klang Valley Mass Rapid Transit (KVMRT) between Sungai Buloh and Kajang, member of parliament (MP) for Petaling Jaya Utara Tony Pua said quite bluntly that the PDP model "is a recipe for inflated project costs".

"A 6% project fee is almost unheard of in a project of this scale," said Pua.

The MP pointed out two major flaws in the government's award of the KVMRT job to the PDP. The first was the fact that the exorbitant fee, which is paid to the PDP, could have been reduced significantly if there were open and competitive tenders.

"The government chose to award the contract and commenced work on the KVMRT before the fee was even agreed upon. Such recklessness on the part of the government has resulted in it being beholden to the PDP with little room to manoeuvre or negotiate.

"Any ordinary man on the street will know that it is ridiculous to ask a contractor to start the kitchen renovation without first agreeing to the cost," said Pua.

The MP explained that on top of their management fee, the PDP will also be separately reimbursed for “overheads, fees for engineering consultancy, quantity surveyors and system integration works and fees for site investigations and topographical survey” amounting to RM2.85 billion.

The second critical flaw of the PDP model, as Pua pointed out, is that the overall cost of the project is incentivised to be inflated due to the structure of the agreements.

He explained that although PDP is supposed to bear any cost overrun for the KVMRT, it has managed to negotiate into its contract a 15% “allowed contingency”.

“Given that the PDP is being paid on a percentage of contract cost and has to bear any cost overrun beyond the 15% ‘allowed contingency’, the PDP which has to help the government evaluate the various tender proposals will be incentivised to pick the bids with higher prices than the lower ones,” said Pua.

Nevertheless, picking contractors at the lowest price is not always a virtue, according to Thong Mun Wai, head of agribusiness, real estate & construction ratings at RAM Rating Services.

“In assessing contractors for work packages, the PDP will be required to carefully evaluate bids by contractors that can deliver according to specifications – and not necessarily awarding them to the lowest bidder. This may reduce the incidence of claims in the future arising from underestimated costs,” said Thong to KINIBIZ.

He also said that regardless of price, the PDP needs to be transparent about its transactions.

“Good corporate governance practices such as transparency and open tenders for contracts as well as having independent engineers to provide checks and balances on the PDP must also be implemented.

“In this regard, the PDP should clearly communicate the scope of work as well as individual risks and responsibilities to sub-contractors to minimise disputes,” said Thong.

Thong further explained the PDP’s role, its relationship with other contractors and some benchmarks that are normally used.

“The PDP essentially plays the role of a project manager on a large-scale undertaking and may even be tasked to manage project funding.

“As such, the selection of a contractor with a good reputation, track record and financial strength is paramount and should form part of its selection criteria; minimum annual turnover and years of relevant experience are examples of benchmarks for a PDP’s appointment.

“In cases where sub-contractors fail to deliver, the PDP is able to intervene to bring the task to completion. In this instance, the incurred costs – such as for sub-contracting work – will be reimbursed by the owner,” said Thong.

On the other hand, head of research at M&A Securities Rosnani Rasul thinks that the government is doing absolutely the right thing by shifting to the PDP model.

“I think the new approach by the government is very good. Local talent is drying up. The PDP model allows the development of new local talent to penetrate the international market for more construction jobs in the future,” said Rosnani to KINIBIZ.

The researcher feels that it is not in the government’s best interest to oversee and manage the projects directly.

“It’s not their area of expertise. They have to get experts to deliver the projects,” said Rosnani.

As for the 6% management fee that has been criticised by some as excessive, Rosnani feels that it is a fairly reasonable amount.

“I think it is acceptable. I’m quite sure the government must have benchmarked against other markets. I don’t think the PDPs earn a fat margin. The 6% fee is spread over five to six years, or whatever the duration of the project is. It would be more profitable for them to be the contractors for the projects.

“Anyway, I don’t think Gamuda would want to accept the job if it was less than market rate, or compared against their other jobs overseas. And I don’t think the government would be foolish enough to offer them less if they wanted Gamuda to take on the job,” said Rosnani.

To compare with other railway projects overseas as a rough benchmark, MTR Corp, the operators of the Hong Kong portion of the Hong Kong-Shenzhen-Guangzhou Express Rail Link, is being paid HK\$4.59 billion (RM2.47 billion) in management fee from the original HK\$65 billion total budget of the project. That works out to about a 7% management fee.

However, with the project plagued by delays and costs of the 142km cross-border high-speed rail project now potentially ballooning 30% to an estimated HK\$85 billion, MTR Corp is now asking for additional management fees, which is being disputed by the Hong Kong government.

Details of the agreement between the Hong Kong government and MTR Corp are not known, so we cannot say that it is an apple to apple comparison with Malaysian PDPs' 6% management fee, but it gives some indication of market rates.

Whatever the fees are, the selection of PDPs still leaves much to be desired, especially in matters of transparency and competitive bidding.

Projects such as the KVMRT and light rail transit involve huge sums of taxpayers' money and unfortunately cost overruns, as shown by the Hong Kong example, are quite common in huge infrastructure projects.

Thus, it is in the public's interest that the government's agreements with PDPs are examined thoroughly before any work commences.

In the next article, KINIBIZ takes a look at ways to further improve the PDP model and iron out its current shortcomings.

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