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REPORT
Meeting Date: 2022-06-23
Regional Council

REPORT TITLE: **Procurement Approach to Managing Impacts of Inflation on Regional Contracts**

FROM: Gary Kent, CPA, CGA, ICD.D, Chief Financial Officer and Commissioner of Corporate Services

RECOMMENDATION

1. **That the Chief Financial Officer and Commissioner of Corporate Services and the Commissioner responsible for the applicable program be authorized, on a case by case basis, to assess and approve requests for contract increases and amendments to offset impacts resulting from market volatility and/or rising inflation, where approval of such requests are deemed by the Commissioners jointly to be appropriate and reasonably necessary to carry on the business of the Region, subject to approved budgets, as such budgets may be increased pursuant to clause two below; and**

2. **That commencing upon the first day during which the acts of Council are restricted pursuant to section 275 of the *Municipal Act, 2001* (lame duck period), and continuing to February 28, 2023, unless further extended by Council, the following authorities are hereby delegated:**
   i) **to the Chief Financial Officer and Commissioner of Corporate Services and Commissioner responsible for the applicable program, authority to increase existing budget(s) by the lesser of 30 per cent of the approved available budget and $500,000; and,**
   ii) **to the Chief Administrative Officer (CAO), authority to increase existing budget(s) by the lesser of 30 per cent and $1 million;**

   on a case-by-case basis in order to facilitate contract increases and amendments approved pursuant to clause one above or to award new contracts, where such increase to the budget is due to market volatility and/or rising inflation, and where such amendments are deemed by the Commissioners or CAO as applicable, to be appropriate and reasonably necessary to carry on the business of the Region.

REPORT HIGHLIGHTS

- The current market price fluctuations are intensifying, which is driving the need to review various current contracts.
- Price volatility and escalations are impacting both commodities and services contracts, including but not limited to the cost of fuel and petroleum products, steel, aluminum, wood, and paint products.
- The impact of war and inflation in addition to the scarcity of resources during COVID-19 Recovery is having impacts on the ability for vendors to deliver materials and services at previously submitted bid prices.
- Implementation of a corporate-wide approach to address both the immediate and longer-term needs, is being recommended. Council authority is being sought to apply a

corporate approach to assess and manage contract price amendments due to market volatility and or rising inflation consistently across the organization.

- Contracts that are amended under this authority will be reported to Council in the Tri-Annual Procurement Activity Report and the Semi-Annual Budget Policy and Reserve Management Policy Compliance Report.
- In the event that Council should find itself in a lame duck position, delegated staff authority is being requested to increase existing budget(s) to accommodate approved contract increases that exceed the budget due to inflationary issues, during any times in which the acts of Council are restricted pursuant to section 275 of the *Municipal Act, 2001* (lame duck period), and continuing to February 28, 2023.
- In accordance with the mandate of the Interim Period Approvals Committee to provide assurance to the public that continuity of conduct of Regional business is administered in an efficient, effective and economical manner during interim periods during such time when there is no regular meeting of Regional Council scheduled for a period of more than 21 days after the date of the previously scheduled regular Regional Council meeting, a meeting of this Committee may be required between July 8 and August 18 to further manage budget increases as may be necessary prior to any potential lame duck period.

DISCUSSION

1. Background

Staff are managing and mitigating an increasing number of issues being raised from contracted vendors, to review current contract terms specifically as they relate to price escalations and delays in satisfying obligations. These concerns can be largely attributed to the current marketplace volatility, which impacts both active contracts which have already been awarded and commenced, as well as potential bids for future construction and operational service contracts. The Region is witnessing price volatility in commodities such as fuel and petroleum products, steel, aluminum, wood, chemicals, labour, paint, etc. Supply chain disruptions and extended lead times for goods and materials required by the Region are contributing to delays in the delivery of capital projects in some program areas, as well as indirect costs to the Region in maintaining vehicles and equipment past their expected useful life. Staff are reviewing risk mitigation measures, where possible, such as bid surety requirements and reduced validity periods, length of contract duration, and pricing mechanisms.

In some cases, the current market conditions have resulted in the termination of active contracts where the vendor is unable or unwilling to continue to satisfy its contractual obligations without price adjustments or surcharges. In other cases, vendors have threatened to walk away from the contract. Additionally, there have been occasions of failed competitive procurement processes due to lack of bids received, where Bidders determined that the risk allocation in times of pricing and materials uncertainty is too great for them to bid. Appendix I provides generic examples of the types of inflationary issues being faced in Regional contracts.

Staff are working to develop a consistent practice across Regional contracts and procurement strategies to not only protect the Region's reputation as a fair and responsive public sector owner, but to also work with the vendor community on a balanced approach to addressing the market volatility. Many current operational contracts are structured such that annual increases are permitted but limited to the applicable Consumer Price Index adjustments, however, this is proving to be insufficient and out of sync with current market volatility and supply chain issues. As a result, delegated authority to review and amend these contracts is recommended and requires a consistent corporate approach should the business case substantiate that such an increase is appropriate and reasonable.

2. Proposed Direction and Risk Mitigation Strategies

Staff are recommending that a two-pronged corporate-wide approach be implemented to address both the immediate and longer-term needs. Staff recommend taking a corporate approach to consistently manage active contracts by seeking delegated authority from Council to amend current contracts for impacts due to inflation as deemed appropriate after proper review and analysis. The evaluation team would consist of procurement, legal, financial supports and program staff, as necessary to complete comprehensive business analysis with considerations including but not limited to; impacts of failure, economic indicators, environmental scans, and mitigation measures undertaken at all levels of government. Continual networking with Local Area Municipalities would ensure consistent practice, particularly with Vendors that are common to all agencies. It is proposed that authority be delegated by Council to the Chief Financial Officer and Commissioner of Corporate Services and the Commissioners responsible for the applicable program to approve contract amendments where increase authority is required and considered appropriate and reasonably necessary to carry on Regional business.

Where approved contract increases exceed the applicable budget(s), delegated authority is sought to increase the budgets to the upset limits identified in the Recommendations during any lame duck period of Council and continuing until the end of February 2023 when the new council will be in place and the 2023 budget will have been presented. Outside of this period, or if it is determined that Council will not be in a lame duck position, budget increases will be brought to Council. This may include calling a meeting of the Interim Period Approvals Committee during the summer period and prior to August 19, if necessary, to address budget increases that may be required prior to any potential lame duck period. Contracts that are amended pursuant to the authorities outlined in this Report will be reported to Council in the Tri-Annual Procurement Activity Report and the Semi-Annual Budget Policy and Reserve Management Policy Compliance Report.

Additionally, staff are currently looking at strategies to mitigate the impact of inflation on the 2023 Budget for both operations and the capital program. Additional information is provided through the June 23, 2022, companion report of the Chief Financial Officer and Commissioner of Corporate Services titled “Overview and Impact of Heightened Inflation on Regional Services”.

Depending on a variety of a factors including the scope of goods and services required, the identified risks to be shared and managed, and the overall complexity of the contracts, the following is a non-exhaustive list of strategies to be assed and employed in the interest of mitigating risk to the Region for both active and future contracts.

a) Active Contracts

Strategies for risk mitigation related to active contracts may include:

- Collaboration with Local Municipalities, Associations and Boards to apply a consistent approach to contract amendments, where possible;

- Development of practices and procedures including authorities and methods to evaluate reasonability of vendor amendment requests for extensions and increases; and,
- Establishment of potential parameters: time limited, situation limited, protect cost certainty and fairness by basing allowable increases upon commercially available price indices, formulas for fair applicability, requirement of proof of cost increases from vendors.

Factors for case-by-case consideration in assessing vendor requests regarding active contract amendments may include:

- The date of the bid submission relative to the date of the requested price increase request;
- The length of the contract;
- The amount of the increase requested;
- The extent to which the contract is reliant upon goods and services that are impacted by inflation and the current market volatility;
- The price escalation provisions of the contract, if any, and the extent to which they may offset the impacts of the current market volatility;
- Whether the Region could secure more favourable pricing by agreeing to terminate the contract and re-tendering (rather than increasing the price);
- Assess whether the situation exists where it would be more advantageous to the Region to extend current contracts with well performing vendors at reasonable prices, as opposed to tendering a new contract in the midst of the current market volatility;
- Where applicable, assess value in issuing short-term contracts to limit risk and allow for the work to be re-bid more frequently until the market stabilized;
- The principle that, to the extent possible, the economic impacts of the current market volatility should be borne equitably between the Region and the vendor; and,
- To compensate for increased costs within fixed project budgets, review opportunities for adjustments within the contracts, such as quantity reductions, location changes, or reductions in project scope or hours of work, where feasible.

b) Future Contracts

Strategies for risk mitigation related to new contracts to be issued by the Region may include:

- Reduced Bid Validity Period in new procurements;
- Ongoing market review of value of bid bonds in new procurements, balanced against risk of bidders not honouring bids, which leads to potential time delays for project completion and costs to the Region;
- Review Liquidated Damages for late project completion, with parameters for when and why they might be forgiven, where materials availability is the cause rather than poor project management or performance;
- Advance Payment for Products purchased early by vendors to protect against price volatility and supply concerns;
- Advance Purchase of Materials by the Region directly for use on projects, where labour is procured separately;
- Incentive clauses in procurement documents to reward vendors for obtaining advantageous pricing;

- Review contingency amounts if available, or reallocation of budget from other sources of funding; and,
- Include price adjustment mechanisms in new contracts, which may include but not be limited to:
    - Price indices to consider/ investigate:
        - Industrial Product Price Index;
        - Non-residential Construction Price Index (NRCPI);
        - Producer Price Index (PPI); and,
        - Fuel Cost Indices.
    - Yardsticks for Costing: Cost Data for the Canadian Construction Industry; and,
    - Pre-purchase and/or pre-selection of major commodities etc. (possible defined list to be included in the specifications).

3. Environmental Scan

Region of Peel staff have conducted an environmental scan of other municipalities within Ontario to determine whether they have had similar requests for contract increases, and their approach. All of these municipalities have reported receiving similar vendor amendment requests related to inflation, commodities and materials, costs of construction, and rising fuel prices. Most of these municipalities are considering each request on a case-by-case basis to determine the reasonableness of the request. Varying approaches have been taken by the municipalities, including negotiated contract increases, outright refusal of any requests for contract increases beyond the provisions of the contract, and termination of the contract and re-tendering. The Region seeks to take an approach that considers all options when deciding the best course of action on a contract-by-contract basis, taking into consideration all relevant factors, including but not limited to, the remaining duration of the existing contract, overall cost impact of the amendment to the Region, and current market conditions.

RISK CONSIDERATIONS

The Region is in a situation where contract breaches and contractor claims are becoming more prevalent and require the need for reviews on a contract-by-contract basis, on how best to address pricing issues whilst still enforcing the contract terms. Without the ability to work with our vendors, and amend current contracts where deemed appropriate, through a reasonable and consistent corporate practice, there could be an increase in work stoppages/delays and/or vendors walking away from contract obligations. A corporate approach is necessary in order to ensure the ability to maintain service delivery and business continuity and avoid service disruption arising from inflationary factors that were not foreseeable by vendors bidding Regional contracts. This approach also allows the Region to maintain positive relationships with our vendor community. It is also important that a business case assessment is applied in the active contracts review, to mitigate unnecessary budget increases.

To maintain competitive tension and reduce over inflated bid prices in future contracts, consistent risk transfer and procurement strategies must be applied. Vendors are being more selective with the contracts they chose to bid on and more inclined to pursue less risky or private sector work. In addition, vendors ability to obtain higher value bonds for larger regional projects may be threatened because of an increased hesitancy of underwriters and surety providers due to market volatility.

FINANCIAL IMPLICATIONS

It is possible that the acts of Council will be restricted by section 275 of the *Municipal Act, 2001* (lame duck provisions) as a result of the upcoming municipal election. This restriction may occur as early as nomination day (August 19). This restricted acts under the *Municipal Act, 2001* include a restriction on the ability of Council to approve expenditures and liabilities which exceed $50,000 unless the expenditure or liability was included in the most recent budget adopted by council. This means that, during a lame duck period, Council would be unable to approve contract increases resulting from inflationary issues that exceed the budgeted amount by more than $50,000, and the Region would be unable to address market volatility impacting key Regional contracts during that period. As a result, delegated authority is being sought to authorize the Chief Financial Officer and Commissioner of Corporate Services, the Commissioners responsible for the applicable program (acting jointly) and the CAO, as applicable, to increase the budgets to the upset levels as set out in the Recommendations during any lame duck period and until the new Council is firmly established and the budget is presented in February 2023. Notwithstanding that Council's acts are restricted during a lame duck period, the *Municipal Act, 2001* makes it clear that these provisions do not prevent the delegation of these authorities to staff prior to nomination day. In addition, a meeting of the Interim Period Approvals Committee may be required between July 8 and August 18 to address any necessary budget increases that may arise due to inflationary issues during that period, prior to the possibility of a lame duck period commencing on August 19.

The market volatility and heightened inflation will likely have significant impacts on Peel's service delivery and increase risk to Peel's overall financial health. For 2022, the increases will be managed through the use of Peel's capital reserves and rate stabilization reserves if required. A June 23, 2022, companion report from the Chief Financial Officer and Commissioner of Corporate Services titled "Overview and Impacts of Heightened Inflation on Regional Services" provides a broad overview on the likely impacts of inflation on Peel's operations, capital program, investments and debt.

APPENDICES

Appendix I – Sample Market place volatility and rising inflation

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