

Larrakeyah housing project budget update

- 5.1 In 2009, the Parliamentary Standing Committee on Public Works conducted an inquiry into the proposed construction and renovation of housing for defence at Larrakeyah Barracks, Darwin. The works were proposed by Defence Housing Australia (DHA), and had an estimated total cost of \$57.6 million (including GST) or \$52.4 million (excluding GST).
- 5.2 This budget figure was included in the statement made by the Parliamentary Secretary for Defence Support, when the proposal was referred to the Committee for inquiry on 17 September 2009. The Committee undertook an inquiry between September and November 2009.
- 5.3 The Committee tabled its report on 23 November 2009. The House of Representatives resolved that it was expedient for the works to proceed on 26 November 2009.
- 5.4 In early 2011, DHA wrote to the Committee seeking its agreement for the project to proceed with an amended budget. The original budget proved to be insufficient to complete the works, and DHA proposed both a reduced scope and larger budget to complete the project.
- 5.5 The Committee held a public hearing into the budget problems on 21 March 2011, and subsequently agreed to the project proceeding with an amended budget. This chapter deals with the issues raised in the hearings, and the Committee's findings about risk management by DHA and in the Australian Government more broadly.

The original inquiry

- 5.6 As noted above, the Committee conducted its original inquiry in 2009. The Committee held public and in-camera hearings on 9 November 2009 in Darwin. During the in-camera hearing, the Committee undertook its usual

inquiries about the strength of the budget, the risks to the project and the robustness of the budget's projections.

- 5.7 The Committee is always diligent in testing the assumptions underlying project budgets. In this case, the Committee had no reason to believe that the budget presented by DHA was problematic. In its report (Report 7/2009), the Committee wrote that:

The Committee is satisfied that the costings for the project provided to it are adequate.¹

- 5.8 As noted above, the Committee recommended that the House of Representatives approve the works, which it did on 26 November 2009. DHA subsequently proceeded with the project.

Correspondence received in 2011

- 5.9 As also noted above, the Committee received correspondence from DHA in early 2011, notifying it that the total budget of the project was insufficient to complete the works. DHA also sought the Committee's agreement to complete the project with an amended budget.
- 5.10 The Committee advised DHA that it would be holding public and in-camera hearings into the budget overrun, and DHA provided the Committee with an updated brief on the budget problems. This has been placed on the Committee's website.²
- 5.11 At its public hearing in March 2011, the Committee heard evidence from representatives of DHA about the reasons for the budget overrun, and some details of the proposed new budget. A transcript of this hearing is also available on the Committee's website.³

Budget overrun

- 5.12 In its correspondence to the Committee, DHA outlined the main deficiency of the original budget. The original budget was \$57.6 million (including GST), and DHA was seeking the Committee's agreement to proceed with a new budget of \$63.8 million (including GST).

1 Parliament of Australia, Parliamentary Standing Committee on Public Works, *Report 7/2009 – Referrals Made August to October 2009*, p. 14.

2 <www.aph.gov.au/house/committee/pwc/briefingdocuments2011>

3 <www.aph.gov.au/house/committee/pwc/briefingdocuments2011>

- 5.13 The civil and housing construction works accounted for the vast majority of the budget overrun. As DHA informed the Committee, initial tenders for these parts of the project ranged from \$68 million to \$97 million, well above the project budget. DHA commenced negotiations with the preferred tenderer, attempting to reduce the tender (with some success). DHA also negotiated with the Department of Defence, in order to save costs by reducing the project scope.
- 5.14 However, these negotiations did not result in a scope and tender that could be funded under the original budget, hence DHA's request for agreement to proceed with a larger budget.

Hearings in 2011

- 5.15 In its background paper, DHA advised the Committee that there were three main reasons for the inadequacy of the original budget:
- Darwin market conditions;
 - cost uncertainties associated with architectural design; and
 - DHA's inexperience with building high-set tropical homes.⁴
- 5.16 During the hearings, the Committee sought DHA's explanation as to why these cost pressures were not sufficiently accounted for during the budget process. It is unacceptable that these risks were only properly understood after the project had been considered by the Committee and Parliament.

Darwin market conditions

- 5.17 Members of the Committee raised the question of market conditions at the hearing in early 2011:

Senator TROETH— ... [We] are certainly aware that there are higher costs not only in Darwin but also in most of North Queensland because labour and building is higher than the rest of Australia. Again, given that Defence has been building in Darwin, I think, since the 1970s, why wouldn't Defence already factor that in? Is there is a sudden leap in the cost of building and labour?

4 Letter from Mr. P. Howman, *Larrakeyah updated budget brief*, 11 March 2011, available at <www.aph.gov.au/house/committee/pwc/briefingdocuments2011>

- 5.18 DHA responded to the Committee that there are significant pressures on the construction industry in Darwin, due to population growth and the limited months in which construction can be undertaken, given the climate patterns.⁵
- 5.19 The Committee is not satisfied with these answers. All the market conditions cited by DHA for the budget inadequacy were foreseeable. The conditions were well known in the local community.

House design

- 5.20 Members of the Committee reminded DHA that, during the original hearing in 2009, it advised that:
- The houses we intend to construct will be tropical-style, high-set homes promoting design principles specific to Darwin and the site conditions.⁶
- 5.21 No mention was made of the risks associated with the design or construction of this style of house. The Committee's usual inquiries about risks were satisfied with assurances from DHA that it had a suitably large contingency to cover any project risks that materialised.
- 5.22 In its original report, the Committee commended DHA for constructing houses that were designed for Darwin's climate.⁷ The Committee continues to support DHA's efforts to improve the capability of the Darwin construction industry to deliver houses that are designed for the local climate.
- 5.23 DHA must properly assess projects on an individual basis. DHA builds a large number of houses around Australia each year, and it cannot simply rely on general assumptions about the cost of housing design and construction. In this case, it was clear that the project differed significantly from previous projects, and DHA should have properly taken this into account.
- 5.24 DHA is conscious that it is pushing the Darwin design and construction industry forward by its decision to build high-set homes. Indeed, at a hearing for a different proposal in 2010 DHA noted:

5 Mr P. Howman, DHA, *Proof Transcript of Evidence*, 21 March 2011, p. 4.

6 Mr P. Howman, DHA, *Proof Transcript of Evidence*, 9 November 2009, p. 2.

7 Parliament of Australia, Parliamentary Standing Committee on Public Works, *Report 7/2009 – Referrals Made August to October 2009*, p. 15.

The committee also witnessed DHA's strategy to reinvigorate the local building industry to be more innovative in taking account of the tropical climate in future housing constructions ... The building industry in Darwin is currently geared to delivering southern style homes and the committee members would have seen much evidence of this this morning while driving around various suburbs to get to Muirhead and to this facility today. DHA has already implemented a strategy leading to affordable house constructions in Muirhead to be more attuned to Darwin climatic conditions, so it has developed a pilot home, which the committee visited this morning, to test various ideas and to show the local building industry the direction in which an important customer is heading.⁸

- 5.25 Again, the Committee is fully supportive of DHA's efforts to encourage housing in Darwin that is more attuned to the local climate. However, DHA must ensure that, if it is seeking tenders for house designs that it knows to be uncommon in the market, it must make sufficient budget allowances.

Committee comment

- 5.26 The Committee is concerned that the reasons for the budget overrun in this case were not unforeseeable. DHA must have been aware that there were local market and industry conditions that could cause problems with the project budget. The Committee considers it unacceptable that DHA did not do more work to identify these risks before the project commenced. The Committee has sought DHA's assurances that its internal budgeting processes have been improved to take account of this unfortunate turn of events. At the budget update hearing in March 2011, DHA assured the Committee that:

Wherever we introduce a new product we need to revisit our process of validating prices, and we have done that recently with some additional broadacre land... We have done the same thing with engineering estimates, where we have employed a couple of different engineers. One will do the estimates, another will do a review of those estimates, but we do not take the halfway measure. We get them all into the room together and keep them

8 Mr. P. Howman, DHA, *Proof Transcript of Evidence*, 15 April 2010, p. 3.

there until we come out with what they agree is the right number.
So we have changed that process for new and different products.

- 5.27 The purpose of risk management is to ensure that projects are not derailed by events or decisions that may or may not occur. In this case, there were numerous market conditions and cost pressures that DHA knew to be risks. They were not entirely unforeseen. However, DHA did not sufficiently investigate their likelihood and impact on the project.
- 5.28 The Committee is left to conclude that either DHA was not properly informed about the extent of the risks to the project, or that it failed to include sufficient budget provision to protect the project. Either way, DHA must improve its internal budget process to ensure that this does not occur again.
- 5.29 The Committee notes that DHA operates on a commercial basis, and that it returns profits to the government by way of dividends. Nonetheless, DHA is a public authority spending public money, and it has a responsibility to ensure that the money is well spent. Robust budgeting is a fundamental part of getting good value for money, and the Committee expects all agencies to ensure that project budgets are properly prepared.

Ms Janelle Saffin MP

Chair

16 June 2011