

# **Value Based Procurement at DFCM**

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**Report to the Executive Appropriations Committee  
Of the Utah State Legislature**

**Prepared by  
The Office of the Legislative Fiscal Analyst**

**Kevin Walthers, Fiscal Analyst**

## **Introduction**

In 1998 the Division of Facilities Construction and Management embarked on a new method for hiring contractors. The process was initially referred to as “Performance Based Procurement” was based on a model developed at Arizona State University for hiring roofing contractors. The theory behind the model was the assumption that low bid contracting encouraged bidders to artificially lower their prices in an effort to win jobs. This practice led to increases in change orders, corner cutting on materials and bid shopping by general contractors. Performance based procurement utilized an extensive spread sheet to weight the work of roofers based on such things as product performance, quality of work and ability to stay on schedule and on budget. Bid winners were no longer the company with the lowest price but the company who demonstrated an ability to perform quality work at a fair price.

Demonstration of quality quickly became an issue with the process. Firms liked the idea that they could offer quality in the bid process, but balked at the extensive amount of work required to submit a bid. Legislators expressed concern with bid management contracts that were being paid to out of state consultants to manage the selection process. In response to these concerns, DFCM revised its procedures in October of 2000, creating a new process called “Value Based Procurement.” The goal of the process remained the same – hire a qualified contractor at a fair price – but the new system significantly reduces the extensive preparation required to bid on projects. Since October of 2000 DFCM used VBS to issue 83 construction contracts and 15 design build contracts. This report is designed to address two primary concerns expressed by legislators in regard to this process:

- ▶ The Value Based System is biased toward only a few firms; and
- ▶ The state is losing money by not awarding contracts to the lowest bidder.

## **Is VBS Biased toward a few firms?**

The Analyst examined DFCM’s list of awards issued for the Value Based System to determine if a pattern was present in the manner of contract award. Over the course of the program (December 2000 thorough 2003) 128 firms bid on 83 different construction projects. Only three firms received multiple awards without submitting a losing a bid and three other firms won the bid on the only project they submitted.

Table 1: Bid Attempts

Failed Bids	Firms	Firm Won	Other Bid(s)
1	66	9	
2	16	1	
3	15	7	
4	10	9	
5	6	3	
6	6	4	
7	0		
8	2	2	
9	0		
10	1	1	
	<u>122</u>	<u>36</u>	

Table 1 indicates that most firms without a winning submission are those that submitted bids on only one or two projects. Of the 122 firms that submitted an unsuccessful bid 36 were successful on at least one other submission. Of the 86 firms that submitted bids without winning one award, 71 submitted proposals for two or less projects. This seems to indicate that part of the process involves a learning curve for firms to attain success with the program.

**Is the state losing money by not using low bid?**

The Value Based System is only one way for DFCM to solicit work from vendors. For simple projects – basic roofing and paving, for example – there is little or no value in using VBS. For those projects DFCM may still issue awards to the “lowest qualified bidder.” Of the 83 construction projects and 15 design-build projects issued with VBS, approximately 41 percent went to the firm with the lowest price. That is, the firm deemed to have the best qualifications and plans was also the cheapest for 34 of the 83 projects with multiple bidders.

Table 2: Percent of Low Bid Awards

	Total Projects	Low Bid	One Bidder	Low Bid Percent
Construction	83	30	13	42.9%
Design/Build	15	4	2	30.8%
	<u>98</u>	<u>34</u>	<u>15</u>	<u>41.0%</u>

Given that nearly sixty percent of bids were awarded to firms that were not the lowest cost, the Analyst compared the incremental difference of the projects to gain some understanding of the potential savings. Overall the Value Based System added three and a half percent to the cost of projects compared to what would have been spent on low bid only. However, many of the projects included “value added” components offered by the vendor such as additional equipment or added space.

Table 3: Relative Cost of VBS

	Construction	Design/Build	Combined
Award Value	136,016,031	80,519,900	216,535,931
Low Bid Difference	5,466,627	2,126,457	7,593,084
Percent of Total	4.02%	2.64%	3.51%

*Note of Caution*

This notion of “value added” could lead to disgruntled bidders in the future. If a vendor bids on the project as proposed but loses to a more expensive bid that includes “extras” the vendor may well feel that the firm was shortchanged in the process. To date there have been only three complaints arising from the 98 projects issued and all three have been settled informally through a meeting of DFCM, Purchasing and the vendor/complainant. To date it seems that all “added value” projects have been within the original budget and have been available to all vendors. However, this process has the potential to allow agencies or institutions to attempt to inflate anticipated costs in hopes of getting “extras” that would not be part of a normal state building project.

It should be noted that the numbers noted above reflect all projects in which the awardees were not the lowest bidder – in some cases the vendor may have had competitors whose awards were even higher.

*How can the Legislature assess “value”?*

Prior to implementation of the Value Based System the State took only low bid proposals then negotiated change orders with contractors. Change orders became a source of tension not only between DFCM and vendors, but also between the Legislature and DFCM. Implementation of VBS sought to eliminate the perceived practice of using change orders to make a profit. In creating the system, DFCM informed the Capital Facilities Committee that initial costs may be higher, but long term project costs should show some savings.

Additional costs on projects are tracked through the Contingency Reserve Fund, with changes reported at each Building Board meeting and an annual balance is provided to the Legislature in the Five Year Book. Overall DFCM reports lower utilization of Contingency funds as contractors work out ways to manage unexpected costs. For those costs that were truly unforeseeable or result from an owner initiated change, the Contingency Fund provides a safety net to ensure that projects are done properly without undue burden on contractors.

In addition to the Contingency Fund, DFCM maintains the Project Reserve Fund – a statutorily created fund into which savings from projects is deposited for future use by the Legislature. Since the implementation of VBS procurement the project reserve increased substantially. Part of the increase can be attributed to uncommonly favorable market conditions, but VBS and DFCM management should share some of the credit.

**Conclusion**

Although VBS is not a perfect system, the State seems to be receiving better projects at a fair price. A project by project analysis is beyond the scope of this study, but the Analyst notes that VBS has played a significant role in bringing projects in on time and under budget. This allowed the Legislature to redirect savings accruing in the Contingency Reserve Fund and the Project Reserve Fund to the DFCM operating budget, freeing up approximately \$3 million in General Fund in both FY 2003 and FY 2004.