



**Comptroller General
of the United States**

Washington, D.C. 20548

Decision

Matter of: The Urban Group, Inc.; McSwain and Associates, Inc.

File: B-281352; B-281353

Date: January 28, 1999

Sam Z. Gdanski, Esq., and Jeffrey I. Gdanski, Esq., for the protesters.
David R. Kohler, Esq., and Audrey H. Liebross, Esq., for the Small Business Administration.

Michael J. Farley, Esq., Department of Housing and Urban Development, for the agency.

Henry J. Gorczycki, Esq., and James A. Spangenberg, Esq., Office of the General Counsel, GAO, participated in the preparation of this decision.

DIGEST

1. Issuance of a section 8(a) set-aside solicitation, which includes work previously performed by small businesses as well as new work, without assessing the adverse impact of the set-aside on small business concerns, is unobjectionable where no adverse impact assessment is required under applicable Small Business Administration (SBA) regulations because the SBA, in interpreting its regulations, reasonably determined that the overall solicitation is radically different from the previously performed work and thus represents new work.
2. A solicitation provision stating that a section 8(a) set-aside will become a small business set-aside if fewer than two acceptable offers from 8(a) firms are received is not contrary to statute or regulation, or unfair to small businesses.
3. Absent clear judicial precedent, General Accounting Office will not consider protest alleging that agency did not have constitutionally sufficient basis for creating a section 8(a) set-aside.
4. Agency's decision to consolidate marketing requirements (previously performed largely in-house) with existing property management contract requirements into larger contracts for both management and marketing services in multiple states is not objectionable under the Small Business Act, 15 U.S.C.A. §§ 631(j)(3), 644(e)(2) (West Supp. 1998), where the resulting benefits are "measurably substantial" and support a determination that the bundling is necessary and justified, and the protester has not identified a reasonable alternative that would provide similar benefits.

DECISION

The Urban Group, Inc. and McSwain and Associates, Inc. protest request for proposals (RFP) No. R-OPC-21230, issued by the Department of Housing and Urban Development (HUD) contemplating up to 16 separate contracts for management and marketing (M&M) services for single family properties in 16 designated areas of the United States. Urban challenges the set-aside for section 8(a) concerns in the area of Florida and Puerto Rico. McSwain challenges the bundling of Alabama, Georgia, Mississippi, North Carolina, and South Carolina into one area.

We deny the protests.

HUD insures hundreds of thousands of Federal Housing Administration (FHA) mortgages. Where defaulted mortgages result in foreclosure by the lender and payment of insurance claims by HUD to the lender, HUD gains title to thousands of properties throughout the country. HUD manages these properties by providing maintenance and repairs, and ultimately sells the properties in order to recoup funds paid on insurance claims. The Real Estate Owned Branch (REO) of HUD's Office of Housing is responsible for managing and marketing these properties. Agency Report on Urban Protest (ARU) at 2; Agency Report on McSwain Protest (ARM) at 2.

Prior to the issuance of this RFP for M&M services, HUD generally contracted for the property management services separately, and the REO staff performed the marketing services in-house with some assistance from advertising contractors. The most recent management contracts were the Real Estate Asset Management (REAM) services contracts, which were usually performed by small business concerns covering small geographic areas and administered by REO staff in 81 HUD field offices. REAM contractors received a fixed-fee for managing the properties, and subcontracted for maintenance and repairs, the cost of which was directly paid by HUD. ARU at 2-3; ARM at 2-3.

Administration of the REAM contracts and marketing properties has been burdensome for HUD. Also, an audit of the REAM contract program, conducted by the General Accounting Office in response to congressional inquiries regarding reports of poor contract administration, found that HUD's oversight of these contracts was inadequate. Single-Family Housing: Improvements Needed in HUD's Oversight of Property Management Contractors (GAO/RCED-98-65, Mar. 1998). This report concluded that this inadequacy may have resulted in a decrease in the marketability of properties, as well as a decrease in the value of surrounding homes and a threat to the health and safety of neighbors and potential buyers, while also increasing the holding costs of these properties for the government. HUD essentially concurs with the conclusions of this report. In addition, HUD is in the process of reducing staff from a 1996 level of 10,500 employees to a 2002 level of

7,500 employees. This will reduce the REO staff from 500 in 1997 to 88 by the end of 1999. The reduced REO staff will transfer from the 81 field offices to 4 regional Home Ownership Centers (HOC).¹ Consequently, HUD needed a more efficient and less costly method for managing and marketing its properties. ARU at 3-4; ARM at 3-4.

In order to decrease the burden of contract oversight and to improve the marketing of the properties, HUD has developed a new approach to its property management and marketing responsibilities, which entails issuing far fewer contracts covering much larger geographic areas, and combining the management and marketing requirements under one contract. Three pilot programs successfully tested this approach. Under these pilot programs, contractors were reimbursed for repairs, but otherwise received a percentage of the price at which each property was sold. These pilot programs met or exceeded the sales goals established by HUD and reduced the average time a property was held by HUD. However, the risk of the cost of repairs and the associated oversight burden still existed for HUD. ARU at 4-5; ARM at 4-5.

To further reduce costs and administrative burden, the final M&M approach also placed responsibility for performing and paying for repairs with the contractor. The resulting solicitation provided financial incentives for the contractor to efficiently maintain, repair and market properties in a manner that would promote the highest possible selling price for each property by compensating the contractor based on a percentage of the sales price. ARU at 5; ARM at 5.

Prior to issuing the current M&M RFP, the agency issued four regional M&M solicitations, one for each HOC. None of these solicitations included small business or section 8(a) set-asides. The Small Business Administration (SBA) objected to these solicitations, recommending that the requirements be subdivided and partially set aside for small business concerns. The regional solicitations were canceled and replaced with the current M&M RFP, which incorporated the SBA's recommendations. ARU at 6-7; ARM at 6-7.

The M&M RFP, issued on August 17, 1998, identified four service regions corresponding to the four HOCs in Philadelphia, Atlanta, Denver and Santa Ana. Each HOC is responsible for 3 to 6 areas for a total of 16 geographic areas. The Atlanta HOC is divided into three areas. Area 2 of the Atlanta HOC, the subject of

¹These HOCs were initially developed to streamline HUD's mortgage insurance processes. ARU at 4; ARM at 4. Four HOCs (Denver, Philadelphia, Atlanta and Santa Ana, California) were created to cover all regions of the country. The mortgage insurance processes were transferred from the 81 HUD field offices to these 4 HOCs, reportedly resulting in great efficiencies in insuring a high volume of home loans. ARU at 1-2; ARM at 1-2.

McSwain's protest, consists of Alabama, Georgia, Mississippi, North Carolina and South Carolina; Area 3, the subject of Urban's protest, consists of Florida and Puerto Rico. RFP § B.II.

The RFP contemplated the award of up to 16 fixed-price, indefinite-quantity contracts, covering the 16 areas, for 1 year with 4 option years. RFP cover letter at 1, §§ B, M.VI. Offerors could submit proposals for as many areas as they chose, with a minimum of one entire area. RFP § M.IV(a).

Contract price was to be determined primarily by applying the offeror's proposed fixed-price factor to the sale or rental price of each property.² RFP § B.III-IV. Except for a limited number of cost-reimbursable services (specified at § C-4.III) the proposed price factors determined the total compensation due for contract performance. RFP § B.III-IV.

The RFP stated the following set-aside procedures at section M.IV:

- (c)(1) In accordance with [Federal Acquisition Regulation (FAR)] Subpart 19.8, any award for . . . Area 3 of the Atlanta HOC . . . resulting from this solicitation, will be made on a competitive basis to eligible Section 8(a) business concerns, provided that a minimum of two (2) competitive (technical and cost) offers are received from eligible Section 8(a) concerns.
- (2) If a minimum of two (2) offers from eligible Section 8(a) concerns are not received, the award for the area(s) specified in (c)(1) above will be made to a small business . . . in accordance with FAR Subpart 19.5, provided that a minimum of two competitive (technical and cost) offers are received from qualified small business concerns.
- (3) If a minimum of two (2) offers from qualified small business concerns are not received, the award for the area(s) specified in (c)(1) above will be made on the basis of full and open competition from among all responsible business concerns submitting offers.

A total of 6 areas were set aside in this manner. The remaining 10 areas had no restrictions on competition. RFP § M.IV. The above set-aside scheme was suggested, and the set-aside areas were selected, by the SBA, and HUD accepted the SBA's recommendations. ARU at 7; ARM at 7.

²Prices for managing properties which are not to be placed on the market are to be based on a proposed fixed monthly rate for custodial properties. RFP § B.III.

Proposals were due on October 20. RFP Amendment 0001, at 1. Urban and McSwain protested prior to the time set for closing.

THE URBAN PROTEST

Urban protests that the agencies failed to determine if any incumbent small business REAM contractor would be adversely affected by the decision to solicit Area 3 of the Atlanta HOC as a section 8(a) set-aside. Urban Protest at 3-5; Urban Comments at 5-8.

Because the Small Business Act affords the SBA and contracting agencies broad discretion in selecting procurements for the section 8(a) program, we will review challenges to decisions to procure requirements under section 8(a) only to ensure that agency officials have not acted in bad faith, and that applicable regulations have been followed. John Blood, B-280318, B-280319, Aug. 31, 1998, 98-2 CPD ¶ 58 at 2; American Consulting Servs., Inc., B-276149.2, B-276537.2, July 31, 1997, 97-2 CPD ¶ 37 at 9. Since it is not alleged here that either HUD or the SBA acted in bad faith, nor does the record so indicate, our review of Urban's protest turns to the applicable regulations.

Section 8(a) of the Small Business Act authorizes the SBA to contract with government agencies and to arrange for performance of such contracts by awarding subcontracts to socially and economically disadvantaged small business concerns. 15 U.S.C. § 637(a) (1994). The implementing regulations for the section 8(a) program provide that the "SBA will not accept a procurement for award as an 8(a) contract" which was not previously in the 8(a) program, where the acceptance of the procurement would have an adverse impact on an individual small business, a group of small businesses located in a specific geographical location, or other small business programs. Section 124.504(c), 63 Fed. Reg. 35756, 35757 (June 30, 1998) (to be codified at 13 C.F.R. § 124.504(c)). An adverse impact is presumed to exist where a small business has been performing the requirement and the requirement represents 25 percent or more of the small business's gross sales. Id. at § 124.504(c)(1)(i)(C). However, if the requirement being procured is a "new" requirement, i.e., one which has not been previously procured by the procuring activity, then the adverse impact rule does not apply, with one exception. Id. at 124.504(c)(1)(ii). That exception to the adverse impact rule states:

In determining whether the acceptance of a requirement would have an adverse impact on a group of small businesses, SBA will consider the effects of combining or consolidating various requirements being performed by two or more small business concerns into a single contract which would be considered a "new" requirement as compared to any of the previous smaller requirements. SBA may find adverse impact to exist if one of the existing small business contractors meets the presumption set forth in paragraph (c)(1)(i) of this section.

Id. at § 124.504(c)(2).

HUD states that this is a new requirement because it has not previously procured the marketing services and certain other requirements encompassed by this RFP, and thus the adverse impact rule does not apply. ARU at 16-17. The SBA agrees. SBA Report at 13.

The SBA states that the above-quoted exception to the adverse impact rule is not applicable where, as here, the consolidation of old requirements performed by small businesses, together with the addition of new requirements not previously procured, creates a "radically" different work requirement from that of the old requirements. SBA Report at 13. The SBA states that, unlike the REAM contracts:

The M&M contractor will not only take responsibility for deciding what repairs to perform on a specific property, but they will also market the properties and obtain much of their remuneration from the sale proceeds.

Id. The SBA thus considers the nature of the M&M contracts to "differ radically" from that of the REAM contracts, and states that the M&M RFP can therefore be set aside for section 8(a) concerns without consideration of adverse impact on small business concerns. Id.

As the agency responsible for promulgating this regulation, the SBA's interpretation deserves great weight, and we are required to give deference to an agency's reasonable interpretation of its regulations. See Red River Serv. Corp., B-279250, May 26, 1998, 98-1 CPD ¶ 142 at 5-6; see also Udall v. Tallman, 380 U.S. 1, 16 (1965).

We think that the SBA's interpretation of its regulation is reasonable. The terms of the exception do not encompass all types of new requirements, of which services previously performed by small businesses are a part. Specifically, the exception does not state that combining services previously performed in-house with otherwise existing contract requirements necessarily constitutes a new requirement subject to the exception; rather, the exception specifically addresses only new requirements which are created by combining existing contract requirements. Therefore, it is not unreasonable to interpret this language as limited only to those new requirements which are created solely from combining existing contract requirements. Since the M&M RFP is a new requirement created by combining marketing requirements previously performed largely in-house with existing management contract requirements, the SBA reasonably determined that the section

8(a) set-asides could be created for this new requirement without an adverse impact analysis.³

Urban next alleges that the conditional nature of the section 8(a) set-aside is unduly burdensome on small business concerns because they do not have the resources to prepare proposals that will not be considered if at least two competitive proposals are submitted by section 8(a) concerns. Urban Protest at 3; Urban Comments at 8.

As set out above, the RFP set-aside scheme for the six designated areas progresses from a section 8(a) set-aside, to a small business set-aside, and finally to an unrestricted procurement, depending on whether sufficient competitive proposals in the set-aside categories are received. Under this scheme, both small and large business concerns must submit proposals in response to the RFP to be considered for award in the event the more restrictive set-aside requirements are not satisfied, even though their proposals would not be evaluated if a contract is awarded under the section 8(a) set-aside.

The SBA recommended this order of precedence approach to HUD as an alternative to a completely unrestricted procurement. ARU at 15; SBA Report at 7. The SBA states that this approach is not barred by any statute or regulation, that the RFP clearly advised potential offerors of the set-aside scheme so that they could assess the risks prior to preparing a proposal, and that qualified small businesses may well be willing to accept the risks associated with the order-of-precedence structure of the set-aside to have the opportunity to receive the relatively large contracts that will be awarded under these set-asides. SBA Report at 8-9.

We are aware of no statute or regulation that would prohibit this approach, nor has the protester identified any such statutory or regulatory restriction. Since the scheme proposed by the SBA and accepted by HUD will have the effect of increasing the opportunity for small business concerns under an otherwise unrestricted solicitation, we have no basis to object to this set-aside scheme as unduly burdensome for small business concerns.

³Urban's allegation that under certain REAM contracts it was permitted to sell certain properties, thus implying that REAM contracts encompassed the marketing requirements in the M&M RFP, Urban Comments at 7, Exhibit 1 at 1, is not supported by the record. The agency has provided a copy of Urban's REAM contract for several counties in Florida, which was awarded in June 1995 and was in effect during this protest. ARU, Exhibit 3. That contract does not include any requirement or authority for Urban to sell or market HUD properties, and Urban has provided no evidence to support its allegations. In any case, Urban acknowledges that the M&M RFP includes HUD REO functions in addition to existing contract requirements. Urban Comments, Exhibit 1 at 3.

Finally, Urban alleges that the section 8(a) set-aside was imposed on Area 3 without assessing the need for such a restriction in that area, which is unconstitutional under the ruling in Adarand Constructors, Inc. v. Peña, 515 U.S. 200 (1995),⁴ as interpreted by the U.S. District Court for the District of Columbia in Cortez III Serv. Corp. v. National Aeronautics & Space Admin., 950 F. Supp. 357 (D.D.C. 1996). Urban Protest at 5-6; Urban Comments at 3-4.

There must be clear judicial precedent on the precise issue presented to us before we will consider a protest based on the asserted unconstitutionality of a procuring agency's actions. Ervin and Assocs., Inc., B-279161 et al., Apr. 20, 1998, 98-1 CPD ¶ 115 at 3. We have consistently held that, since the Court in Adarand simply announced the standard that is to be applied in determining the constitutionality of programs involving racial classifications in the federal government and remanded the case to the lower court for further consideration in light of that standard, Adarand did not provide that precedent. Id.

The ruling in Cortez applied the standard stated in Adarand to a federal agency's decision to restrict a solicitation as a section 8(a) set-aside, and discussed the corresponding analysis which the court determined that the agency was required to perform before doing so. Cortez v. NASA, 950 F. Supp. at 361-363. However, as noted by the SBA and HUD, the Cortez decision concerned only a motion for a preliminary injunction without a fully developed record, and the SBA advises that this matter previously has had limited exposure in the courts and is now the subject of on-going litigation in other courts. HUD Letter, January 21, 1999, at 6; SBA Letter, January 21, 1999, at 4-7. Since the Cortez decision is not binding on other courts and since the effect of the Adarand decision remains a contentious issue in the area of federal procurements, we do not think that the Cortez decision represents the clear judicial precedent that our Office requires to rule on protests alleging unconstitutional agency action. Thus, we decline to consider Urban's protest on this basis.

THE McSWAIN PROTEST

McSwain challenges the agency's designation of Area 2 of the Atlanta HOC for unrestricted competition, alleging that the five-state region which comprises Area 2 of the Atlanta HOC under the RFP was created by improperly bundling a large number of smaller REAM contract areas without assessing the impact on small business concerns and that if this area were broken up further it would be suitable for small business set-asides. McSwain Protest at 2-3; McSwain Comments at 1-2.

⁴In Adarand, the Supreme Court held that racial classifications must be subject to strict scrutiny and must serve a compelling governmental interest and be narrowly tailored to further that interest. Adarand v. Peña, 515 U.S. at 224-27.

The Competition in Contracting Act of 1984, 41 U.S.C. § 253a(a) (1994), generally requires that solicitations permit full and open competition and contain restrictive provisions or conditions only to the extent necessary to satisfy the needs of the agency. Since bundled, consolidated, or total-package procurements combine separate, multiple requirements into one contract, they have the potential for restricting competition by excluding firms that can furnish only a portion of the requirement. Aalco Forwarding, Inc., et al., B-277241.12, B-277241.13, Dec. 29, 1997, 97-2 CPD ¶ 175 at 6. Furthermore, the Small Business Act, 15 U.S.C.A. § 631(j)(3) (West Supp. 1998), states that, "to the maximum extent practicable," each agency shall "avoid unnecessary and unjustified bundling of contract requirements that precludes small business participation in procurements as prime contractors." We will review such solicitations to determine whether the approach is necessary and justified to satisfy the agency's needs. See Aalco Forwarding, Inc., et al., *supra*.

The Small Business Act, 15 § U.S.C.A. 644(e)(2)(A), states that, before proceeding with an acquisition strategy that could lead to a contract containing consolidated procurement requirements, the head of an agency shall conduct market research to determine whether consolidation of the requirements is necessary and justified. An agency may determine that consolidation of requirements is "necessary and justified if, as compared to the benefits that would be derived from contracting to meet those requirements if not consolidated, the Federal Government would derive from the consolidation measurably substantial benefits, including any combination of benefits that, in combination, are measurably substantial." 15 U.S.C.A. § 644(e)(2)(B). Such benefits may include: (i) cost savings, (ii) quality improvements, (iii) reduction in acquisition cycle times, (iv) better terms and conditions, or (v) any other benefits. *Id.* "The reduction of administrative or personnel costs alone shall not be a justification for bundling of contract requirements unless the cost savings are expected to be substantial in relation to the dollar value of the procurement requirements to be consolidated." 15 U.S.C.A. § 644(e)(2)(C).

HUD does not consider these requirements as bundled, as defined by the Small Business Act,⁵ because the RFP includes previously unsolicited marketing services

⁵"Bundling of contract requirements" is defined by the Small Business Act, 15 U.S.C.A. § 632(o)(2), as:

consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small-business concern due to--

(A) the diversity, size, or specialized nature of the elements of the performance specified;

(continued...)

and completely redesigns HUD's property management and marketing methodology.⁶ ARM at 16-19. The SBA disagrees because the RFP includes substantial services previously provided or performed under separate smaller contracts. SBA Report at 8 n.3. However, HUD and the SBA both conclude that any bundling that may exist under this RFP was necessary and justified. ARM Report at 19-23; SBA Report at 8 n.3, 9. As discussed below, whether or not this RFP involved bundling, as defined under the Small Business Act, the protester has not established that the bundling was unnecessary or unjustified.

McSwain does not object to the bundling of the various types of services provided in previous contracts with the newly solicited types of services. What McSwain protests is the combination of numerous small geographical regions that were previously the subject of REAM contracts into a single five-state area because, while McSwain "possesses excellent skills in all aspects as required in [the RFP,] but [they are] not at a level of multi-state management."⁷ McSwain Protest at 3, Attachment 1 at 1.

Here, the M&M RFP includes consolidation of geographical areas of management service contracts previously administered by HUD's 81 field offices into 16 areas, which will be administered by the four HOCs as well as additional services not previously obtained by contract. HUD's REO was faced with the converging problems of being unable to adequately administer the large number of REAM contracts with the staff it had, as well as having a severely reduced staff in the near future. The impetus for the M&M RFP approach was a documented need for improved program efficiency and quality in the face of fewer resources to administer the program. Realistically, these circumstances left REO with little, if any, alternative to reducing its contract administrative burden by having far fewer contracts encompassing more requirements and by incentivizing the contractors to

⁵(...continued)

(B) the aggregate dollar value of the anticipated award;

(C) the geographical dispersion of the contract performance sites;

or

(D) any combination of the factors described in subparagraphs

(A), (B), and (C).

⁶Because HUD did not consider the RFP to involve bundling, it did not perform a formal market survey, as envisioned by the Small Business Act, 15 U.S.C.A. § 644(e)(2)(A).

⁷McSwain's protest indicates interest in North Carolina work.

more efficiently and successfully perform the M&M work.⁸ The structure of the M&M RFP can reasonably be expected to reduce the amount of oversight by REO staff by reducing the number of contracts from hundreds of REAM contracts administered from 81 field offices to a maximum of 16 contracts administered from 4 HOCs. ARM at 19-20.

Additionally, the financial incentive for each contractor to perform the maintenance and repairs which they deem necessary to enable them to sell the contract at the highest possible price and to maximize profits will add a self-monitoring component that was not possible under the REAM contracting approach. Id. Furthermore, the transfer of the marketing function to the contractors should provide improved performance over REO's in-house performance, as illustrated by the pilot program results. This should increase program efficiency and reduce program costs. Id. The total result should reduce the administrative burden sufficiently so that the small REO staff will be able to adequately administer these contracts. Id.

HUD also believes that the improved oversight under the M&M contracting approach, together with the financial incentives for contractors to achieve the highest price for the properties under their contracts, will improve the conditions of the properties, which in turn will increase the value of surrounding properties and improve the health and safety of the neighborhoods. ARM at 22. Although this is yet to be proven by results, the expectation appears reasonable.

The SBA agrees with HUD that the restructuring of HUD's requirements was necessary, and that the resulting benefits in cost savings and quality improvements are substantial and justify the consolidation of property management requirements into the M&M approach. SBA Report at 10. Furthermore, the SBA worked with HUD to ensure that the RFP provides opportunities to the maximum extent practicable for small business concerns, both as prime contractors and subcontractors, and urges our Office not to disturb the resulting structure of the RFP. Id.

We conclude that the record supports the finding that substantial benefits of cost savings and quality improvements will likely result from the consolidation of the previously contracted-out requirements with HUD's new requirements into contracts covering relatively large areas, and that these benefits go beyond reducing administrative and personnel costs alone. The expected improved program efficiency and quality, as well as the substantial potential cost savings, support the

⁸The results of HUD's pilot programs indicated that considerable efficiencies, cost savings, and improved quality and marketability of HUD properties could be achieved through a consolidation of the services under a single contractor. ARM at 5, Exhibit 6.

finding that the consolidation of the requirements under the M&M RFP approach was necessary and justified.

Given the protester's statement that it does not have "multi-state" capability, it evidently seeks breaking up the five-state area in question into much smaller pieces, presumably a contract for each state. This would result in a proliferation of contract vehicles that would undermine the basic benefits of the program. The protester has failed to identify a reasonable alternative to the RFP consolidation that would provide similar benefits. Thus, we cannot say this particular five-state grouping was unnecessary or unjustified.

The protests are denied.

Comptroller General
of the United States