Quick Guide to Cost and Price Analysis for HUD Grantees and Funding Recipients

Who is this guide for?

This guide is for all HUD grantees and funding recipients that contract for services and/or supplies using funds provided in whole or in part by HUD.

What is price analysis?

Price analysis is essentially price comparison. It is the evaluation of a proposed price (i.e., lump sum) without analyzing any of the separate cost elements that it is composed of.

What is cost analysis?

Cost analysis is the evaluation of the separate elements (e.g., labor, materials, etc.) that make up a contractor's total cost proposal or price (for both new contracts and modifications) to determine if they are allowable, directed related to the requirement and ultimately, reasonable.

Is cost or price analysis always required?

Yes. HUD's regulations at 24 Code of Federal Regulations (CFR) Part 84, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and 24 CFR Part 85, "Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments," require grantees to perform a cost or price analysis for *every* procurement action, including contract modifications (e.g., "change orders"), using HUD grant funds.

When do I perform a price analysis?

You use price analysis whenever you are comparing lump sum prices – not cost estimates - received from contractors in a competitive pricing situation (e.g., when sealed bids are obtained).

What qualifies as competition?

Generally, competition means two or more responsible (e.g., not debarred or suspended, etc.) offerors ("bidders"), competing independently, submit priced offers that satisfy the grantee's contract requirement. Obviously, the greater the number of offers received, the greater the competition and ideally, the better the pricing.

When do I perform a cost analysis?

Cost analysis is used whenever you do not have price competition. A cost analysis is required when:

- Using the ***competitive proposal*** (or "negotiated") method of contracting (see 24 CFR 85.36(d)(3) for a definition), e.g., for acquiring professional, consulting or architect/engineering (A/E) services. Under the competitive proposal method, offerors are required to submit cost proposals that show the elements (e.g., labor, materials, overhead, profit) of their proposed costs or price.

- Negotiating a contract with a ***sole source***, i.e., not soliciting competitive bids or offers. When a sole source is appropriate and justified (see 24 CFR 85.36(d)(4)), you must obtain a complete cost breakdown from the sole source contractor and perform an analysis using the cost principles to establish a fair and reasonable price or estimated cost.

- After soliciting competitive sealed bids, you receive ***only one bid***, and it differs substantially from your independent estimate of the contract price. If you determine that the bid is unreasonable and decide to not recompete (e.g., market survey tells you that you wouldn't get competition), then you may formally cancel the solicitation and negotiate a contract price with the single bidder. In that case, you must obtain a cost breakdown of the single bid price and use cost principles to determine if that price is reasonable.

- Negotiating a ***modification*** (including change orders) to *any* type of contract, if the modification changes the work authorized under the contract, and changes the price or total estimated cost, either upwards *or* downwards. You must obtain a detailed breakdown of the contractor's proposed cost - not a lump sum proposal - before negotiating the change in contract price.

  CAUTION*: Modifications that change the work beyond the scope of the contract must be justified in accordance with the conditions set forth in 24 CFR 85.36(d)(4) or 24 CFR 84.43. If the out-of-scope change cannot be justified, you must procure the work competitively.*

Could there ever be a situation where I don't have price competition, and I don't have to perform a cost analysis?

Yes. There are two situations:

- The price can be established on the basis of catalog or market prices of commercial products or services sold in substantial quantities to the general public. A product is considered to be "sold in substantial quantity" when the regular sales volume is large

enough to constitute a real commercial market. Services are considered to be "sold in substantial quantity" when the contractor/vendor customarily provides them, using his/her regularly employed personnel and using equipment (if any is needed) regularly maintained solely to provide the services.

or

- The price is set by law or regulation.

Do I need to analyze and negotiate profit separately?

Whenever you are required to perform a cost analysis, and you are negotiating a contract action that provides for a profit or fee, you must negotiate profit separately. When negotiating profit, you should consider ***all*** of the following:

- The complexity of the work to be performed. The more difficult the work, the more profit a contractor may be entitled to.

- Contractor's risk. How much risk – either performance or cost to the contractor - will the contract create? The higher the risk, the higher the reward, i.e., profit.

- Contractor's investment (labor, oversight, etc.). How much and what type of resources will the contractor have to dedicate to performing the contract? The greater the investment of resources the more profit.

- Subcontracting. The amount of profit depends upon the size, nature and oversight needs of the subcontracts the contractor will use. Will the contractor perform most of the work, or will he/she sub out some of it, and if so, how much? Will subcontracted work be routine or complex? What amount and level of oversight and management will subcontracted work require of the contractor? Simple subcontracts for routine supplies of services should not be worth as much profit as complex subcontracts that require a lot oversight by your own highly skilled staff or management.

- Quality of the contractor's past performance. Profit should reward the contractor for a proven record of high quality performance. A consistent record of delivering quality goods or services on time within cost, indicates that the contractor will likely "deliver the goods" to you, too. (Note: You probably won't be considering a poor performer for a new contract award.) Performance under the current contract must be considered when negotiating a modification.

- Industry profit rates in the surrounding geographical areas for similar work. What's the "going rate," especially for standard, more commercial types of work? ***CAUTION:*** Be careful to not pay going rates when the work required is not really covered by those rates, e.g., paying specialty rates for routine work.

CAUTION! *The* ***"cost-plus-a-percentage-of-cost"*** *and* ***"percentage-of-construction-cost"*** *contract types are prohibited. (See also 24 CFR 85.36(f)(4), and 24 CFR 84.44(c).) These types of contracts reward contractors for incurring greater costs, which is just the opposite of what is in your, the buyer's, best interest.*

How do cost analysis and price analysis apply to the different contracting methods?

- *Small Purchases*. For routine, commercial type purchases, comparing price or rate quotes obtained from an adequate number of qualified vendors is sufficient price analysis. If the small purchase is for professional or technical services, or the HA needs to evaluate other factors than price, then at least a limited cost analysis is appropriate. In either case, the HA's analysis should include comparing the proposed prices to past prices it has paid for the same or similar items or services.

- *Sealed Bidding*. This is the preferred method for contracting for supplies, equipment and construction. (See 24 CFR 85.36(d)(2) for a definition.) Normally, the competitive pricing forces of the marketplace determine the reasonableness of the low price obtained through sealed bidding. Nevertheless, the HA should always compare its own independent cost estimate to the low competitive bid received. In the event they are significantly different, the HA will need to examine each to verify that either its own estimate or the market price is valid. Otherwise, no further price or cost analysis is required under sealed bidding.

  CAUTION! *When only one bid is received in response to a competitive bid solicitation, you do not have price competition. If you decide to award on the basis of a single submitted bid price, i.e., without negotiation, you must justify that the price is fair and reasonable. At a minimum, you should compare the bid price to your own in-house estimate and past prices paid for the same or substantially similar item(s) in the past. You should also try to obtain information from the marketplace, if you have not already done so in developing your own estimate. If you decide to cancel the sealed bid and negotiate a contract price with the single bidder, you must obtain a complete cost breakdown and perform a cost analysis of the proposed price. If the bidder refuses to provide a breakdown of his/her costs, you may have no other choice than to resolicit bids. In any case, you must document the rationale for your award decision.*

- *Competitive Proposals*. This method is most often used to contract for professional, consulting, and architect/engineering (A/E) services. (See 24 CFR 85.36(d)(3) for a definition.) To determine the reasonableness of proposed costs, you must obtain cost breakdowns from the offerors showing all the elements of their proposed total costs and perform a cost analysis of each proposal using the appropriate set of cost principles (discussed below).

  NOTE! *When awarding a contract using the competitive proposal method, the type of contract (e.g., firm fixed-price or cost-reimbursement) you propose to award does not affect the requirement for a cost analysis. For example, if you intend to award a firm*

fixed-price contract via the competitive proposal method, you still must analyze all of the proposed costs contained in each offeror's price. However, you are not required to negotiate each individual cost element in arriving at an agreement on total price. The final price you negotiate with the contractor on a fixed-price contract normally reflects agreement only on the total price. Therefore, the overall objective should be to negotiate total prices that are fair and reasonable.

NOTE! *In certain cases, the contract may specify separately priced items. This is commonly done in indefinite- delivery (e.g., indefinite-quantity, sometimes called job order, or "open ended") contracts. Under these contracts, the HA orders pre-priced items on an as-needed basis, up to a stated maximum quantity. For these contracts, agreement must be reached on each item's price before award and the prices included in the final contract document.*

- *Noncompetitive Proposals*. These are sometimes called sole source contracts and are different from single bids. No competition is intended, and usually, there is no market to help set the price or estimated cost. Since there is no price competition to tell you if the price or estimated cost is reasonable, you must obtain a breakdown of the proposed costs and perform a cost analysis.

What other contract actions or types require cost analysis?

- *Contract Modifications*. If you are negotiating a modification (including change orders) to any contract (even if the basic contract was awarded competitively through sealed bidding) that changes the scope of work previously authorized and impacts the price or estimated cost, you must use cost analysis to arrive at a reasonable cost. The only exception to this rule is a contract modification based on pricing terms already established in the contract document. Keep in mind that changes in scope do not always result in increased costs. Elimination or reduction of contract work may result in a decrease in the contract price. Regardless of the direction of the price change, these modifications require cost analysis using the cost principles to determine that the price change is fair and reasonable.

- *Contract Terminations*. Terminating a contract means unilaterally ending it before its stated end. Contracts can be terminated for the convenience of the grantee or for cause (also called default). Contracts are usually terminated for convenience when the buyer no longer has a need for the service or products as they are specified in the contract, or when it is not possible to substantiate that the contractor's performance is poor enough to terminate him/her for cause. Contracts may be terminated for cause when the contractor fails to perform the contract as written. If you are terminating a contract of any type (fixed-price or cost-reimbursement) for convenience, or a cost-reimbursement contract for cause, you must use cost analysis - and the appropriate cost principles - to negotiate the final amount of the termination settlement.

NOTE! *For contracts with for-profit entities and nonprofits listed in Attachment C to OMB Circular A-122, the cost principle at FAR 31.205-42 specifically addresses termination costs.*

- *Cost-reimbursement Contracts*. In determining reasonable costs under any cost-reimbursement contract, a cost analysis using the cost principles is required.

- *Architect/Engineer Contracts*. Cost analysis is required in determining if the cost portion of an A/E contract is fair and reasonable.

- *Construction Contracts*. This includes all contracts and contract modifications negotiated on the basis of cost for construction management or construction, alteration or repair of buildings, bridges, roads, or other kinds of real property. It does not include contracts for equipment, or other kinds of personal property. Construction contracts awarded using sealed bidding ***do not*** require cost analysis (see *Sealed Bidding* above), but construction contracts awarded using any method other than sealed bidding, and modifications to construction contracts do require cost analysis (see *Modifications* above).

  NOTE! *Because of widely varying factors in construction work such as the nature, size, duration, and location of the construction project, advance agreements for such items as home office overhead, partners' compensation, employment of consultants, and equipment usage costs, etc., can be particularly important in construction and A/E contracts. When appropriate, they serve to express the parties' understanding regarding work starts and any costs are incurred. This helps to avoid possible disputes or disallowances later. Guidance on the use of advance agreements is found at FAR 31.109.*

How do I perform an analysis?

Here are some basic techniques.

Price analysis. Use as many of the following techniques as applicable and appropriate:

- Compare competitive prices received in response to the solicitation to one another. This assumes you receive a large enough number of competitively priced offers from the current marketplace.

- Compare proposed prices with prices under existing contracts and with prices proposed in the past for the same or similar items/services. Be sure to factor in any market changes (e.g., commodity price changes) or other influences (e.g., inflation).

- Apply rough yardsticks (e.g., dollars per pound, per square foot, per hour, etc.) to compare prices and highlight significant inconsistencies that warrant additional pricing inquiry.

- Compare competitive price lists, published catalog or market prices of commodities and products, similar indices and discount or rebate arrangements.

- Compare proposed prices with your independent (i.e., in-house) cost estimates.

Cost Analysis.

- Verify the accuracy of the cost and pricing information submitted, and evaluate:

  - The reasonableness of the proposed costs, including allowances for contingencies. To be considered reasonable, proposed costs must meet three critical tests. The costs must be:

    ⇒ *Allowable*. The applicable cost principles (see section below) will usually state whether a type of cost is allowable or not.

    ⇒ *Allocable*. This means that the costs are logically related to, or required in the performance of the contract. Many costs may be allowable but not related to the work required under the contract.

    ⇒ *Reasonable*. This term is generally defined as what a prudent business would pay in a competitive marketplace. A cost can be allowable and allocable, and still not be what a prudent businessperson would pay (e.g., first class airfare for a proposed subcontractor).

  - The necessity for proposed cost items. Technical personnel (e.g., engineer, architect, information systems specialist, etc.) should review the proposed direct cost elements to determine their necessity to perform the contract and reasonableness (e.g., in comparison to market rates). A cost may be allowable under the cost principles and even allocable to the type of work to be performed, *but* still not be necessary for the specific contract.

  - Application of audited or pre-negotiated (e.g., by the Federal Government) indirect cost (e.g., overhead) rates, labor and fringe benefit rates, or other factors.

  - Effect of the offeror's current practices on future costs. Does the offeror have a track record of containing costs (completing contracts at or “under cost”)? Does he/she overrun costs?

  - The projection of the offeror's cost trends. Is there any indication that his/her costs are likely to increase or decrease over the life of the contract?

- Compare costs proposed by the offeror with:

- Actual costs previously incurred by the same contractor for the same or similar work. If it is a repetitive type of work or service, how much has it cost in the past. Apply any appropriate inflation factors for past work.

- Actual costs of previous the same or similar work performed by other contractors.

- Previous cost estimates from the offeror or other offerors for the same or similar items.

- The methods proposed by the offeror with the requirements of the solicitation (i.e., do the costs reflect the technical approach proposed and the work required?).

- The HA's independent cost estimate, either created by HA staff or for the HA by an independent architect, engineer, appraiser, etc.

➢ Verify that the offeror's cost submissions comply with the appropriate set of cost principles.

What are cost principles?

Cost principles describe the allowability of various types of costs (e.g., labor, travel, communications, etc.). The HUD regulations at 24 CFR Part 85, "Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments" (specifically, section 85.22, "Allowable costs"), and 24 CFR Part 84, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations" (specifically, section 84.27, "Allowable costs") require you to use them when performing cost analysis.

Which cost principles do I use?

It depends upon the type of organization with which you are contracting. The use of one set or another is contract-specific. For example, if the contract is with a private business concern, use the principles in FAR Subpart 31.2 (see below). Here is a list of the cost principles and the types of organizations covered by each:

State, local and tribal governments	Office of Management and Budget (OMB) Circular A-87
Private nonprofit organizations other than institutions of higher education or hospitals	OMB Circular A-122
Educational institution	OMB Circular A-21

Private, profit-making entities and nonprofits listed in Attachment C of OMB Circular A-122	Federal Acquisition Regulation (FAR), 48 CFR Chapter 1, Subpart 31.2

NOTE! *When applying the cost principles in FAR Subpart 31.2, the following terms shall be read to refer to the HUD grantee/funding recipient: "Government," "agency," "contracting officer" and "administrative contracting officer" ("ACO"). The term "contractor" shall refer to the grantee's/funding recipient's contractor. FAR 31.001 contains a glossary of technical terms used in Subpart 31.2.*

Where can I find the cost principles?

The cost principles are available online:

OMB Circulars: http://www.whitehouse.gov/omb/circulars/index.html

FAR Subpart 31.2: http://www.arnet.gov/far/

THIS PAGE INTENTIONALLY LEFT BLANK