



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 3

Approval of IT Services Contracts

OVERVIEW

On April 15, 2011 the City's Purchasing and Contracting department released Request for Proposal (RFP) No. 10015345-11-Z to select a vendor(s) to provide Information Technology (IT) Services for the City of San Diego for a term of five-years with two one-year options. Possible vendors were asked to provide pricing for each of the following service areas and/or the vendor could choose to provide individual pricing for one of the areas:

- Data Center Services
- Voice Network Services & Data Network Services
- Application Development & Maintenance Services
- Service Desk Services
- Desktop Support Services

After review of responsive proposals by the City's RFP evaluation team, four companies were invited to submit their Best and Final Offer (BAFO) Proposals. Based on their BAFO, three firms entered into contract negotiations to provide the following IT Services to the City:

- Data Center Services: Atos IT Solutions & Services, Inc.
- Service Desk & Desktop Support Services: Atos IT Solutions & Services, Inc
- Application Development & Maintenance Services: CGI Technologies & Solutions
- Data/Voice Network Services: ACS State & Local Solutions, Inc.

Atos is an international IT services company with 74,000 employees (3,692 in the United States). CGI is also an international IT services company with 31,000 employees (10,021 in the United States). ACS is subsidiary of Xerox and has a total of 3,101 employees dedicated to IT outsourcing services who are located in the United States.

At the April 18, 2012 Rules, Open Government and Intergovernmental Relations Committee (Rules) Information Technology (IT) Department staff will be asking the committee to approve five-year contracts with two one-year options with Atos (Data Center, Service Desk and Desktop Support Services) and CGI (Application Development & Maintenance Services) for a total of \$117.8 million. Completion of negotiations with ACS has been delayed due to a protest lodged by AT&T for the Data/Voice Network Services and this service area is not being considered for approval at this time. Staff states that they plan on having this resolved by June if not earlier.

It is important to note that per the City Attorney's Office, if the City Council were to not approve the selected vendors a new RFP would need to be issued.

FISCAL/POLICY DISCUSSION

Overview of Proposed IT Contracts

The following sections highlight key issues related to the proposed IT Contracts with Atos and CGI. In addition, Attachment 1 to this report provides a comparison of the expenses from the new vendors to that of the current providers for the first five-years of the contract.

IT Service Area "Run the Business" Fixed Costs

As noted in the IT Department's April 11, 2012 report to the Rules Committee, the contracts with Atos and CGI utilize a "fixed" annual cost per year over the term of the contract (Five-years) to "Run the Business" for each of the three service areas for a total of \$90.8 million. The following are items to note regarding the contracts with Atos and CGI:

- The contracts allow for nominal variances in service levels without changing the fixed costs. Staff's April 11th report notes that if the City should experience a sustained increase or decrease in needs then the price of the contract would be adjusted to reflect the new volume. ***The IBA recommends that the Rules Committee ask IT staff how these changes and related cost adjustments will be transparent and reported to the City Council. We would note that historically the proposed and final budgets have reflected adjustments to IT accounts in each department's commentary but they are not summarized by commitment item in the budget documents. This makes it very difficult to ascertain the annual adjustments and total IT expenditures.***
- The contracts for the three services areas each reflect a decrease in cost over the five-year term. Staff states that the reason for the decrease is that as the vendors become more familiar with the City's operations the opportunity for increased efficiencies will occur which the pricing reflects.
- The vendors include \$3.7 million in one-time transition costs as part of the pricing for Fiscal Year 2013 in Data Services (\$2.725 million) and for Fiscal Years 2013 and 2014 in Service Desk & Desktop Support Services (\$1.031 million). Concurrently, the City will also be expending one-time funds on transitioning the current vendors out. These expenses are discussed below in the Legacy Service Cost Components section.

In order to estimate the savings related to the proposed contracts with Atos and CGI, IT staff was required to calculate an Annual Baseline Cost for the City's existing IT service providers for the

three service areas. Staff calculated the Annual Baseline Cost to be \$28.9 million using a combination of historic cost data, Fiscal Year 2011 actual expenses, current Fiscal Year 2012 budget amounts, and projected Fiscal Year 2013 expenses. The breakdown of Annual Baseline Costs can be found in Appendix A - Table 4 of staff's April 11th report.

The Rules Committee might want to ask staff to clarify why they have included an inflationary adjustment to the Annual Baseline Costs for the current vendors. The Annual Baseline Costs include an inflation adjustment of 1.5% in FY 2014 and 2% in Fiscal Years 2015-2017. Staff states that the inflation assumption is based on projections by private Blue Chip analysis, the Congressional Budget Office' projection of real US GDP growth, and changes in the US consumer price index. However, it is important to note that SDDPC's annual budgets for services provided to the City has decreased from \$42.0 in Fiscal Year 2009 to \$34.4 million in Fiscal Year 2012 and is anticipated to be around \$27.7 million for Fiscal Year 2013. ***Based on this information, the inclusion of an inflation adjustment when historical budget data reflects decreases is inconsistent. Although staff explains how they developed the inflation adjustments for the Annual Baseline Costs in their report, they do not explain why they are being included.***

Legacy Service Cost Components

The transfer of the City's IT services from our existing providers to the new vendors will require the City to assume a number of responsibilities previously administered by our existing providers and incur one-time expenditures related to the transition. Staff has identified \$51.8 million in Legacy Service Cost Components for the five-year term of the contracts with \$11.5 million related to one-time expenses. Table 5 in Appendix C to staff's April 11th report provides a list of the items included in the Legacy Service Cost Components. The following provides items of interest regarding the Legacy Service Cost Components:

- \$9.9 million in one-time expenditures for SDDPC to support the existing Data Center in Fiscal Year 2013 (\$6.5 million), Legacy application maintenance (\$3.0 million), and Desktop, Security & Application Support (\$400,000) until the new vendors can assume these services.
- \$1.2 million in one-time expenditures for En Pointe to provide Help Desk & Desktop Support until the new vendor, Atos, can assume these services.
- \$4.5 million in on-going funding (\$900,000 annually over the five years) related to the City assuming the Customer Relationship Management (CRM) function from SDDPC. As a result of the City assuming the CRM function, staff is anticipating that 5.00 Program Manager positions will be requested to be added to the Fiscal Year 2013 Budget as part of the Mayor's May Revision (these positions are currently not in the proposed budget). These positions will augment 1.00 FTE already existing in the department. Staff estimates that it costs SDDPC \$940,000 annually to provide the CRM function and once City staff is hired the annual City expenses are expected to be \$900,000 for a savings of \$40,000 annually.

IT Discretionary Costs

In addition to the \$90.8 million in fixed costs, staff is also asking the Rules Committee to approve \$26.9 million in discretionary funding with Atos and CGI over five years. Staff states that \$18.1 million will be used for Application Development and Enhancement Support for Services historically provided by SDDPC and \$390,000 for Application support related to the Data Center equipment moves. Both of these expenses have been included as part of the \$51.8 million in Legacy Service Cost Components. Staff states that the remaining \$8.5 million is for the future replacement of infrastructure. The \$8.5 million was not included as part of the Legacy Services Components. The IBA asked IT staff why the \$8.5 million was not included as part of the overall cost comparison of the new to current vendors. They responded that regardless of who was providing the services, these expenses would be necessary and they would be added to both the new and current vendors cost projections thus netting out the impacts.

Operational Benefits

In their April 11th report, IT staff notes two operational benefits associated with the Industry Standard services requirements of the new contracts. These benefits include enforceable penalties for failure to meet service levels and Disaster Recovery & Business Continuity. Details on each of these benefits are included in Appendix B of staff's April 11th report. Staff estimates that the value of these two operational benefits is \$12.7 million over the five-year contract period and includes them as part of their calculation of savings when comparing the new and current vendors.

The IBA agrees that these are improved benefits to the City and establishes an environment where penalties will be enforced if the service levels are not met given that lost productivity does have financial implications. In addition, with the benefits associated with the Disaster Recovery & Business Continuity, the City is positioning itself to survive an incident that could impair the City's ability to provide essential services. We would note that the RFP called for a Tier 3 Data Center and CGI will be providing a Tier 4 data center (Located in Arlington, Texas) with a redundant Tier 3 data center (Located in Plano, Texas). However, we do caution that in reality the City will not see a \$12.7 million reduction to the City's annual budget over the five-years as a result of these benefits.

Proposed Savings

If the contracts with Atos and CGI are approved, staff is anticipating the savings to the City over the five-year term of the contracts to be \$7.4 million on the low end (\$1.5 million annually) to \$20.1 million on the high end (\$4.0 million annually). As discussed above, these savings are based on a number of variables and estimates. Changing these variables, such as not including an inflationary adjustment in the current Annual Baseline Costs, drastically reduces the overall savings to \$2.1 million on the low end (\$423,053 annually) and \$14.8 million on the high end (\$2.96 million) over the five-year contract term. In addition, due to the transition to the new vendors, the City will be required to expend an estimated \$15.2 million in one-time costs (\$3.7 million in transition costs included in the "Run the Business" fixed rates and \$11.5 million in Legacy Service Cost Components). As noted above in the Operational Benefits section, staff has identified two operational benefits valued at \$12.7 million that the City will receive as a result of transitioning to the new vendors and this benefit is included in staff's high end savings estimates. The following table details the five year savings comparisons:

	New Vendors	Current Vendors (With Inflation Adjustment) ⁽¹⁾	Current Vendors (with no Inflation Adjustment) ⁽²⁾
Total "Run the Business" Costs & Legacy Service Cost Components:	\$142,625,821	\$150,051,118	\$144,741,085
Projected Savings When Compared to Current Vendors:		(\$7,425,297)	(\$2,115,264)
Projected Savings When Compared to Current Vendors including \$12.7 in "Operational Benefits"⁽³⁾:		(\$20,085,297)	(\$14,775,264)

⁽¹⁾Includes \$28.9 million in Annual Baseline Costs with inflation adjustment of 1.5% in Fiscal Year 2014 and 2% in subsequent years.

⁽²⁾Includes \$28.9 million in Annual Baseline Costs with no inflation adjustments.

⁽³⁾Operational Benefits include \$10.92 million in Enforcable Penalties for Failure to Meet Service Levels and \$1.74 million for Disaster Recovery & business Continuity.

The IBA did ask IT staff what the savings split would be between the City's General Fund and Non-General Funds and they were not able to produce this information. ***The IBA recommends that if this proposal moves forward that staff include information on what the annual expenses would for the General Fund and Non-General Funds as well as the split for the anticipated savings.***

The IBA would note that the transition to new vendors will be a huge undertaking for the City, particularly in light of the change in administrations at the end of this year. We acknowledge that the City could experience savings as a result of transitioning IT vendors and we will also gain operational benefits that we have previously not had. However, based on a change in variables, the savings could be drastically reduced. Staff does include in their report a number of benefits that are in addition to those already discussed in the Operation Benefits section above. These include the fixed pricing, and a number of items related to transparency and governance. We agree that these benefits are important but it is unclear from staff's April 11th report what the operational benefits will be to the City. Examples of those benefits could be better customer service, faster networks, and newer equipment that help City employees to develop increased efficiencies in their daily responsibilities. ***The IBA recommends that the Rules Committee ask the IT staff to expand on what the operational benefits will be to the City as a result of the change in vendors.***

Other Items to Consider

Staffing

In IT staff's April 11th report, they provide a comparison of staffing from the current providers to the new environment which includes the outside vendors and the City's CRM positions for the three service areas. Staff estimates that of the 128.00 positions working for the current vendors, a total of 111.00 positions will remain locally including 72.00 with CGI, 33.00 with Atos, and 6.00 with the City resulting in an overall reduction of 17.00 positions from the current vendors.

The IBA asked IT staff how many of the 111.00 positions will be filled by DPC staff and they provided the following information:

- For the 72.00 local positions associated with CGI:
 - 5.00 will be leadership roles that will relocate to San Diego.
 - 67.00 will be hired from the local job market with 57.00 of those expected to come from SDDPC.

- For the 33.00 local positions associated with Atos:
 - 5.00 will be leadership roles that will relocate to San Diego
 - 28.00 will be hired from the local job market. Currently, 15.00 of those have come from SDDPC with four additional offers pending.

In addition, CGI and Atos will apply remote resources as needed to meet the City's requirements for service delivery. IT staff notes that ultimately the vendors will provide any resources that are necessary to meet the fixed cost contractual service level requirements at no additional cost to the City.

Impacts to the Fiscal Year 2013 Proposed Budget

IT staff has stated that the Fiscal Year 2013 Proposed Budget does not anticipate any savings due to the transition to the new vendors. Staff notes that the one-time transitional costs are expected to be expended during the first two years of the contracts. This will result in an overlap in service delivery as the old vendors cycle out and the new ones assume their responsibilities. Staff has identified \$12.75 million in one-time expenditures for Fiscal Year 2013. The Fiscal Year 2013 Proposed Budget includes \$6.0 million for the General Fund transition costs in the Citywide Department. However, it is unclear where the additional \$6.75 million will come from although staff has stated that the additional funding is non-general fund related. ***The IBA recommends that the Rules Committee request that staff provide a breakdown of the total one-time transition costs by fund and the fiscal year in which they will occur.***

In addition, as discussed above, 5.00 program manager positions for the CRM function at an estimated cost of \$900,000 annually will be requested to be added to the Fiscal Year 2013 Budget as part of the Mayor's May revise.

Optional Two-Year Extension of Contracts

Staff notes in their April 11th report that in addition to the five-year contracts they have negotiated pricing for two one-year options for extension with each of the companies. Attachment 2 to this report provides a comparison of the expenses from the new contracts compared to that of the existing services providers for a total of seven years which includes the first five-years and the approval of the two optional years. We would note that to calculate the savings for the two optional years, staff continues to use the \$28.9 million in Annual Baseline Costs with a 2.0% inflationary adjustment for the two years. Staff estimates the total savings over the seven years to range from \$21.6 million to \$39.4 million. The \$39.4 million savings is based on including \$17.7 million related to Operational Benefits for seven years instead of the \$12.7 million that has been included for five years. If the inflationary adjustment were not included, the savings would range from \$10.0 million to \$27.7 million over the seven year period.

Future of San Diego Data Processing Corporation

In their April 11th report to the Rules Committee, staff states that SDDPC did not submit a proposal, nor were they proposed as a subcontractor for any of the proposals. However, staff notes that SDDPC did participate in the RFP response with ACS State & Local Solutions. The IBA asked SDDPC management why they did not submit a proposal of their own. In response, SDDPC stated that two requirements included in the RFP prohibited them from responding independently. The first was the requirement for a Tier III Data Center which DPC currently does not have, and had not been a requirement in the past, and the second was the requirement of penalties being paid for non-performance. SDDPC management stated that with an estimated 84% of DPC's revenue coming from the City of San Diego, if SDDPC were to pay penalties for non-performance then the City would be penalizing itself.

If these contracts are approved the future of SDDPC is unclear. SDDPC management stated that they currently have 190.00 employees working on both City and non-city services. Based on the figures provided by IT Department staff, 76.00 former SDDPC employees are expected to be hired by the new vendors. Based on these figures, 114.00 SDDPC employees will be impacted. ***The IBA would note that at some point in the near future the City Council, as the sole member of the Corporation, will need to discuss the future of SDDPC. Specifically, what happens to SDDPC if the City transitions to the new vendors?***

CONCLUSION

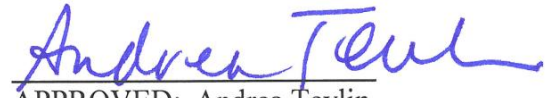
The IBA has reviewed the IT outsourcing proposal for three of the four service areas and has the following recommendations:

- ***The IBA recommends that the Rules Committee ask IT staff how contractual changes and related cost adjustments related to increases or decreases in services will be reported to the City Council. We would note that historically the proposed and final budgets have reflected adjustments to IT accounts in each department's commentary but they are not summarized by commitment item in the budget documents. This makes it very difficult to ascertain the annual adjustments and total IT expenditures.***
- ***The Rules Committee should ask IT staff to explain why annual inflationary adjustments have been included in the Annual Baseline Costs when historical SDDPC budget data reflects decreases.***
- ***The IBA recommends that if this proposal moves forward that staff include information on what the annual expenses would for the General Fund and Non-General Funds as well as the split for the anticipated savings.***
- ***The IBA recommends that the Rules Committee ask the IT staff to expand on what the operational benefits will be to the City as a result of the change in vendors.***
- ***The IBA recommends that the Rules Committee request that staff come back with a breakdown of the total one-time transition costs by fund and the fiscal year in which they plan on expending these funds.***

- *The IBA would note that at some point in the near future the City Council, as the sole member of the Corporation, will need to discuss the future of SDDPC. Specifically, what happens to SDDPC if the City transitions to the new vendors?*



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Deputy Director



APPROVED: Andrea Tevlin
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Attachments:

1. Comparison of Five-Year New IT Vendors to Current Vendors
2. Comparison of Seven-Year New IT Vendors to Current Vendors