



SHELTERED MARKET PROGRAM:
Need for clearer focus and stronger management

January 2010

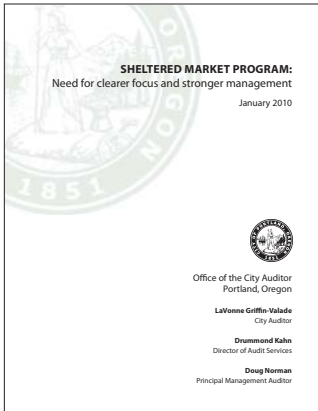


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January 6, 2010

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SUBJECT: Sheltered Market Program: Need for clearer focus and stronger management
(Report #379)

The attached report contains the results of our audit of the City's Sheltered Market Program. The program was established in 1997 along with several other initiatives to support minority-owned, women-owned, and emerging small businesses through targeted contracts for services. The audit assessed whether the program was meeting original goals and how well it was monitoring compliance and overseeing contractor selection and development. Our work included a review of constitutional and case law, research on similar initiatives nationwide, interviews with national experts and City staff, and an extensive analysis of program data and outcomes.

Portland has long championed efforts to increase the participation of historically under-represented minorities, women, and emerging small businesses in awarding City contracts. The Sheltered Market Program represents a substantial commitment to respond to these important community concerns. During the first dozen years of the program, the City awarded nearly \$14 million in prime construction contracts and many contractors were afforded opportunities that might not otherwise have been available. Staff reported that most projects were positive experiences for both participating contractors and bureaus. Although these are promising signs of success, our audit identified problems that undermine the program.

Our audit found that the Sheltered Market Program lacks a well-defined focus – where goals and processes are consistent and clearly understood by decision-makers and the public. In addition, we found weaknesses in program management systems, processes, and oversight. These problems led to a number of costly contract failures and left many participants ill-prepared to compete in the local construction industry. Our recommendations offer guidance on managing this important program more effectively and transparently, improvements that will better serve the City and the community.

LaVonne Griffin-Valade, City Auditor

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Table of Contents

Summary	1
Background	4
Audit Results	
Some Sheltered Market participants not prepared for city contracting	7
Despite recent improvements, City and outside agency use of the program has declined.....	10
Lack of reliable systems for tracking program performance and contractor compliance.....	12
Sheltered Market Program presents conflicting goals for the Bureau of Purchases	13
Focus of Sheltered Market Program Unclear	15
Disparity study outdated	18
Conclusions and Recommendations	19
Objectives, Scope and Methodology	21
Appendix A: Sheltered Market contracts by ethnicity, FY 1997-98 through Fy 2008-09	23
Responses to the audit	27

SHELTERED MARKET PROGRAM:

Need for clearer focus and stronger management

Summary In 1997, City Council established the Sheltered Market Program to improve opportunities and build the capacity of minority-owned, women-owned, and emerging small businesses to compete in the open market as prime construction contractors. The program was formed based on a 1996 disparity study which found that minority- and women-owned businesses were subject to discrimination in the regional construction industry. Through the program, the Bureau of Purchases directs about half of the City's construction contracts valued between \$50,000 and \$200,000 to participating firms, and uses them as the first source on informal construction contracts valued between \$5,000 and \$100,000.

Over the past twelve years, the City awarded 167 prime construction contracts valued at \$13.7 million to firms participating in the Sheltered Market Program. In addition, the Bureau of Purchases helped build the capacity of participating firms by providing them with training and assistance on specific construction projects. City officials see the program as an important tool for helping minority- and women-owned businesses, as well as emerging small businesses, develop and compete effectively in the local construction industry.

Despite the program's achievements, we identified several shortcomings in the Sheltered Market Program. First, the Bureau of Purchases does not have a systematic approach to training and technical support and, as a result, not all Sheltered Market participants are prepared to manage construction contracts they have been awarded by the City. Some of these unprepared contractors hire subcontractors to perform 100 percent of the construction work, contrary to a program rule that limits such subcontracting to 50 percent. Other

contractors attempt to perform the construction, but do substandard work, resulting in significant delays and increased costs to the City.

We found a decline in participation in the Sheltered Market Program, leading to reduced competition in the bidding process. In addition, the Bureau of Purchases lacks good information on program activities and performance. For example, the Bureau does not track Sheltered Market graduates and does not know if the program is increasing the number of prime contractors competing for City construction projects. We also found that the Bureau fails to track participant compliance with program requirements.

Further, placement of the Sheltered Market Program in the Bureau of Purchases presents conflicting goals for the Bureau. First, the Bureau is responsible for the City's bidding and contract award processes, and for protecting the City's interests by authorizing contract change orders and the City's final payment to a contractor. At the same time, the Bureau is responsible for promoting, selecting, and assisting Sheltered Market contractors. These are conflicting responsibilities, a conclusion echoed by a 2007 study of the Bureau of Purchases' organization and staffing by an outside consultant.

Finally, we found conflicting information on whether or not the Sheltered Market Program was intended to address contracting disparities identified in the 1996 disparity study. We were told by City staff that the program was not intended to address disparities. On the other hand, language in the City ordinance that adopted the Sheltered Market Program indicated that, among other purposes, the program was "intended to rectify the disparity found in the awarding of City of Portland contracts to prime contractors." City data show that since the program began in 1997, 51 percent of the contract dollars awarded under the program went to Caucasian males, compared to 11 percent of contract dollars that went to African Americans – the only group with a statistically significant disparity in both the dollar and number of contracts awarded to them, according to the 1996 consortium-wide disparity analysis.

As a follow-up to the outdated 1996 disparity study, the City and the Portland Development Commission have jointly entered into an \$831,000 contract for a new disparity study to be completed in 2010. The new study should provide up-to-date information on construction contracting disparities and on the forms of discrimination that led to these disparities. As the study is conducted and completed, City Council will stand at an important crossroad. The new study offers Council the opportunity to clarify the purpose and focus of the Sheltered Market Program, and to ensure that needed operational improvements are adopted in order to make the program more successful. As it approaches this crossroad, we recommend that City Council:

1. Move responsibility for the Sheltered Market Program to a bureau, or bureaus, that are separate and independent from the Bureau of Purchases.
2. Ensure that a more systematic strategy is adopted for developing the skills of Sheltered Market contractors.
3. Ensure that better systems are developed for tracking and reporting program performance and for monitoring contractor compliance with program requirements.
4. Use the new disparity study as an opportunity to clarify the purpose and focus of the Sheltered Market Program – whether it is intended to rectify specific disparities and the forms of discrimination associated with those disparities, or whether it is intended to help all emerging small businesses, including those owned by women and minorities. Regardless of the focus Council selects, it must ensure that the program’s goals are clear to participating contractors and the public, and that progress in achieving the stated goals is tracked and reported.

Background

The United States Supreme Court determined in the 1989 City of Richmond vs. J.A. Croson Co. decision that public affirmative action programs utilizing racial classifications were subject to strict scrutiny review in the courts. Under this review, the question is not whether racial classifications are benign or remedial, but rather whether the classifications are narrowly tailored and further a compelling state interest in addressing proven discrimination. The statistical and anecdotal analysis involved in examining the basis for affirmative action programs in public contracting has typically been undertaken in the form of disparity studies.

As a result of the Croson decision, the City of Portland eliminated its minority and women's business goals program in 1990, and later co-sponsored the Oregon Regional Consortium Disparity Study which was completed in May 1996. The disparity study found that minority- and women-owned businesses were subject to discrimination in the regional construction industry. In turn, the City adopted the Fair Contracting and Employment Strategy in 1997 which established as its vision/mission:

"To achieve greater economic and social equity in our community, the City of Portland seeks race and gender parity in the amount allotted for procurement of goods and services by awarding contracts to a diverse and competitive group of local contractors while providing significant employment opportunities to minorities and women."

Consistent with the Fair Contracting and Employment Strategy and as recommended by the 1996 disparity study, the City of Portland established the Sheltered Market Program and other programs that serve minority business enterprises (MBEs), women business enterprises (WBEs), and emerging small businesses (ESBs), collectively M/W/ESBs, including:

- The Good Faith Effort Program which requires prime contractors to make an effort to provide subcontracting opportunities to certified M/W/ESBs.
- The Technical Assistance Program which provides technical assistance, training, workshops, and classes for Sheltered Market and other M/W/ESB contractors.

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- The Workforce Training and Hiring Program which endeavors to increase the numbers of women and minorities in the construction trades through apprenticeship opportunities on City of Portland projects.
 - The Mentor-Protégé Program in which mature firms mentor M/W/ESB firms and help them gain experience and build capacity.

Sheltered Market Program

The City of Portland's Sheltered Market Program was established in 1997 to improve opportunities and build the capacity of state certified MBEs, WBEs, and ESBs to compete in the open market as prime construction contractors. Sheltered Market firms can compete exclusively as prime contractors for about half of the City's construction projects in the \$50,000 to \$200,000 range, and are the first source of City informal construction contracts with a dollar value of \$5,000 to \$100,000. In addition, the City designates Sheltered Market firms as the first source for subcontracting on some of its large construction projects, and requires that an attempt be made to use them as subcontractors on all construction projects bid within the Sheltered Market Program. Since the program's inception in 1997, the City of Portland has awarded 167 construction contracts valued at \$13.7 million to firms in the Sheltered Market program.

The Sheltered Market Program is managed by staff in the Outside Services Group within the Bureau of Purchases. The program's FY 2008-09 budget was approximately \$365,000, including \$157,000 to cover salary costs, \$140,000 to pay for consultants, and \$50,000 for classes and workshops. The Sheltered Market Coordinator administers the program's qualification process, coordinates training and technical assistance provided to program participants by consultants, and provides assistance to staff from the five participating bureaus – the Bureau of Water, the Bureau of Environmental Services, the Bureau of Parks and Recreation, the Bureau of Transportation, and Facilities Services. Multnomah County, the Portland Housing Authority, and the Portland Development Commission also were original participants in the program, but their involvement has either been reduced or stopped altogether.

Program Requirements

To qualify for the Sheltered Market Program, a firm must be certified by the State of Oregon's Office of Minority, Women and Emerging Small Business as an MBE, WBE, or ESB, and must submit a contractor's prequalification application or already be prequalified with the City. The firm must have been in business for at least two years and have experience bidding and performing in the specific area of work as identified in the contractor's prequalification application. The City may waive the two-year requirement if personnel within the firm have at least three to five years of appropriate work experience. The firm's average annual gross receipts cannot exceed \$1 million a year for the prior three years, at the time of application. The firm must agree to an assessment of technical assistance needs by a consultant named by the City and participate in appropriately tailored technical assistance. Sheltered Market firms must have the ability to perform at least 50 percent of the construction on a given project or obtain written approval of a lesser percentage by the Sheltered Market Coordinator; however, the firm is expected to manage 100 percent of a given project.

Disparities Identified in the 1996 Disparity Study

The 1996 Oregon Regional Consortium Disparity Study was performed in behalf of the City of Portland, the Portland Development Commission, Multnomah County, Metro, the Oregon Department of Transportation, the Oregon Department of Administrative Services, the Oregon State System of Higher Education, Tri-Met, Washington County, and the City of Gresham. We have cited in this audit report the consortium-wide disparity analysis that included data from all 10 consortium jurisdictions *except* the City of Portland. Portland's data was excluded because the study's consultant found inaccuracies in Portland's subcontractor utilization data. The study's disparity analysis specific to the City of Portland was also unreliable, again because of inaccuracies in Portland's utilization data. We cite the study's consortium-wide disparity analysis in this audit report because it is the most relevant and reliable disparity information available from the study.

Audit Results

Some Sheltered Market participants not prepared for City contracting

The purpose of the Sheltered Market Program is to develop MBE, WBE, and ESB firms into prime contractors who have the capacity to successfully compete in the local construction industry. According to the Bureau of Purchases, increasing the number of prime contractors in the local construction industry also increases competition for City contracts which, in turn, should lower the cost of City construction projects. To help achieve this goal, the Bureau hires business consultants to give Sheltered Market participants the training and assistance they need to bid on City construction projects and carry out construction contract management.

Participants are required to receive a business assessment upon entering the Sheltered Market Program. This assessment is used to develop a business plan that participants are expected to follow to obtain the specified training and assistance they need to perform effectively as construction contractors. However, we found that participants do not always follow through on their business plans, and the Bureau does not take steps to ensure business plans are carried out.

Contractors attend training when possible and receive project management assistance at their request, upon approval by the Sheltered Market Coordinator. However, Sheltered Market managers told us that their first priority is to get contractors bidding and working on City projects. They believe that participants develop prime contracting skills by working on City projects while they are members of the program.

This practice has resulted in failed contracts that have negatively impacted the time and cost to complete City construction projects. While City project managers told us many Sheltered Market contracts are successful, they also said the severity of problems with failed contracts overshadows the successful ones. Although contractor performance is an issue under any contracting circumstances, our review suggests there are several weaknesses in the Sheltered Market Program that need to be addressed to improve the performance of program participants.

We found that Sheltered Market participants are sometimes awarded contracts that involve specific classes of work (e.g., electrical and plumbing) where they lack essential skills and experience. This is done to help contractors gain experience and learn by doing. However, we found some projects where the Sheltered Market contractor hired subcontractors to perform *all* the construction work, contrary to program rules that require the prime contractor to perform at least 50 percent of construction work. We found other projects where the contractor attempted to perform the construction but did substandard work, resulting in significant delays and increased costs to the City. In some cases, the City terminated the contract with the Sheltered Market participant; in other cases, the City elected to terminate the construction project altogether.

Following are examples of poor performance by Sheltered Market firms that illustrate problems that arise when the contractors are not adequately prepared for the required construction work. As stated earlier, many Sheltered Market contracts are successful; these examples are not a representative sample and should not be generalized to all contracts.

In one project that occurred in 2004, a Sheltered Market firm was awarded a contract to rebuild a garage. The contractor set concrete forms that were out-of-square and used a substandard concrete mix. As a result, the finished asphalt was so uneven that a prescribed seal plate could not be installed. The City's project manager spent a significant amount of time working with the contractor on problems with the work, and finally concluded that the contractor lacked the skills to build a garage and ordered a work stoppage. The project was eventually terminated by mutual consent, and the contractor was paid \$9,000 for work completed on the project.

Another project involved the installation of a cooling system. The Sheltered Market firm hired an electrical subcontractor who was unlicensed, performed work that was not up to code, and installed one electrical unit backwards. The Sheltered Market firm was eventually fired from the job and another contractor was hired to complete the

work. The project manager held many meetings with the City Attorney's Office, the Bureau of Purchases, and the contractor's attorney to deal with the problems. Because of all the delays, it took two months to complete the project instead of the planned two weeks.

A third project involved the construction of a fire truck garage. At the time of project bidding, the Sheltered Market firm was involved in a contract dispute with another City bureau claiming nonperformance. The bureau asked to be excused from having to accept the contractor's bid due to the nonperformance dispute in the other bureau, but was required to accept the contractor's lowest bid by State law, according to the Bureau of Purchases. The contractor incorrectly estimated the size of the concrete slabs/footings required on the project before bid submission, and later requested a change order to cover higher than expected concrete costs. The City eventually granted a change order to cover the higher concrete costs plus increased excavation and salary costs. The project manager and inspector spent a lot of extra time working with the contractor, including providing advice on where to buy building materials. In addition, the contractor hired subcontractors to perform over three-fourths of the construction work on the project, contrary to program rules.

City Project Managers and Inspectors Provide Assistance

When a Sheltered Market contractor lacks essential skills needed to manage a City construction contract, the City's project manager often takes on the role of assisting the contractor with project management and contract administration. We were told that both project managers and inspectors spend extra time providing assistance to such Sheltered Market contractors because the contractors lack the skills and experience they need to manage a City construction contract.

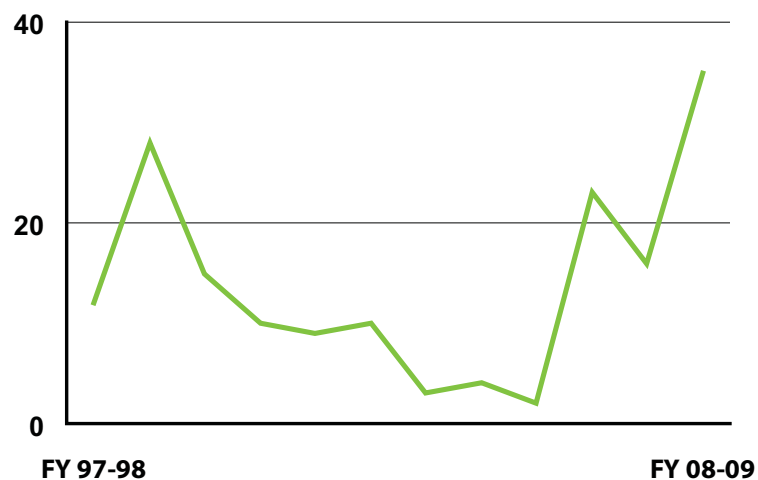
One of the responsibilities of project managers is to inspect construction work to make sure that it complies with contract terms. They are also responsible for reviewing construction claims, recommending appropriate actions, and negotiating with the contractor to resolve disputes. However, when project managers take on the role of mentoring and assisting contractors, the City assumes a greater

risk because they may feel compelled to be more flexible when they inspect the work completed by the same contractor they are mentoring. We were told by several project managers that they are more lenient when it comes to enforcing the terms of Sheltered Market contracts. Project managers also told us that giving advice to contractors takes extra time that delays completion of a project and increases costs.

Despite recent improvements, City and outside agency use of the program has declined

We were told by City project managers that the quality of Sheltered Market contracting improved when the current Sheltered Market Coordinator was hired in June 2007. The new Coordinator has been very active at working with Sheltered Market contractors to help them succeed on individual construction projects. In addition, the number of contracts awarded to Sheltered Market firms has spiked in recent years, increasing from an all-time low of just two contracts in FY 2005-06 to a high of 35 contracts in FY 2008-09 (see Figure 1). Bureau of Purchases staff told us this increase in contracts is due to increased marketing and the establishment of an internal process for ensuring that City bureaus give consideration to the Sheltered Market Program on all appropriately-sized construction projects.

Figure 1 Number of Sheltered Market contracts awarded by the City (FY 1997-98 through FY 2008-09)



Source: Data provided by the Bureau of Purchases.

Despite these improvements, there has been a general decline in participation in the Sheltered Market Program by City bureaus and outside agencies. The Portland Development Commission and the Bureau of Transportation are currently not using the program at all. Multnomah County submitted two projects for bid in the program in FY 2006-07 and submitted no projects in FY 2007-08. Multnomah County representatives told us there are not enough qualified contractors in the program to make using it practical. Staff in the Bureau of Environmental Services said there are too few contractors in the program who are qualified to bid on their projects. The Portland Housing Authority is making very limited use of the program, focusing instead on increasing contracting opportunities for all M/W/ESBs.

In addition, there has been a decline in the number of program participants. Since the Sheltered Market Program began in 1997, a total of 306 firms have been admitted to the program. Sixty-six of these participants graduated from the program, while 179 participants dropped out or were removed from the program by the Bureau of Purchases (see Figure 2). The number of firms enrolling in the program declined from 229 during the first six years of the program (FY 1997-98 through FY 2002-03), to just 77 firms during the last six years (FY 2003-04 through FY 2008-09). The program averaged 95 participants during its first six years, but averaged 56 participants during the last six years.

Figure 2 Sheltered Market Program participant history
(FY 1997-98 through FY 2008-09)

Entered program	306
Removed by City	123
Dropped out	56
Graduated	66

Source: Data provided by the Bureau of Purchases.

Note: Participants may be removed from the program if they have broken the program's conditions, or they lose their certification as an MBE, WBE, or ESB, or they may drop out of the program for personal or business reasons.

As discussed earlier, the reduced number of Sheltered Market firms has negatively impacted participation by some City bureaus and outside agencies. We were also told that the reduced number of participants can have an adverse effect on the bidding process. Project managers said they sometimes submit contracts to the Sheltered Market but receive too few bids; in turn, the project has to be re-bid, delaying the project at least two months and increasing costs. Project managers also said the small number of Sheltered Market bidders reduces competition and results in higher bids than would otherwise be received in the open market.

Lack of reliable systems for tracking program performance and contractor compliance

The Bureau of Purchases does not have good systems in place for tracking the activities and performance of the Sheltered Market Program. For example, the Bureau has not developed a measure to assess whether or not the program is effective at developing program participants into successful prime contractors, which is one of its primary goals. According to program managers, if former Sheltered Market participants are in business and bidding on projects, then the program is a success. However, they said it is difficult to determine if former participants are currently bidding on projects and working as prime contractors.

The Bureau also does not track the number of contracts awarded to Sheltered Market firms by partner agencies. As a result, complete data on the number of all public contracts awarded to participants of the Sheltered Market Program is not available. While the Bureau provides limited program information in its annual report, this information is insufficient to assess program performance. Program managers said they do not have the resources to consistently document, track and report program performance.

In addition, the Bureau does not report program activities and performance to participating City bureaus or outside agencies. Although the FY 2007-08 agreement between the City of Portland and Multnomah County specifically required the Bureau of Purchases to submit quarterly reports on Sheltered Market firm participation in

training classes, and to provide the County with contract assessment reports, the Bureau did not submit these reports to the County. Various staff we interviewed from participating City bureaus told us they do not receive any reports on program performance, but would like to.

We were told by managers of the Sheltered Market Program that their first priority is to develop contractors by assisting them with bidding, estimating, and other related work. However, without clear program performance measures and reliable performance data and reporting, the Bureau of Purchases cannot demonstrate whether the Sheltered Market Program is effective at meeting its goals of helping improve opportunities and building the capacity of targeted contractors. In order to effectively market the services and outreach of the Sheltered Market Program, and to obtain the necessary support and resources for the program, the Bureau of Purchases needs to clearly and consistently communicate the program's performance and results.

The Bureau of Purchases also lacks adequate procedures for monitoring and documenting contractor compliance with program requirements. For example, we found that program staff did not document whether or not participants:

- executed the business plans prepared for them by technical consultants,
- attended mandatory training sessions,
- performed the minimum 50 percent of construction work on their project, or
- performed 100 percent of project management, as required.

Program managers told us that their existing compliance-tracking spreadsheets are cumbersome to use, and consequently they have stopped using them.

**Sheltered Market
Program presents
conflicting goals for the
Bureau of Purchases**

The Bureau of Purchases is responsible for the City's bidding and contract award processes, and for ensuring that contracts contain provisions that protect the City's interests. In addition, the Bureau is responsible for approving contract change orders and for authorizing

the City's final payment made to a contractor. At the same time, the Bureau qualifies and selects firms for the Sheltered Market Program, ensures that other City bureaus are using these firms, and provides assistance to help Sheltered Market firms succeed in their contracts. We believe the Bureau's promotion, selection, and assistance of Sheltered Market firms could compromise the Bureau's ability to provide a fair and competitive contract awards process, and similarly impair its ability to protect the City's interests when authorizing change orders and the contractor's final payment.

A study of the Bureau of Purchases organization and staffing by an outside consultant in late 2007 found that the goals of the Bureau's Outside Services Group, which runs the Sheltered Market and other minority outreach programs, were in conflict with other goals of the Bureau, and recommended that the Outside Services Group be eliminated. We agree that the conflict in goals should be resolved. One solution would be to move responsibility for the Sheltered Market Program to a separate, independent bureau, or bureaus. For example, responsibility for training and assisting Sheltered Market firms could be moved to the Portland Bureau of Housing or the Portland Development Commission. The Economic Opportunity Initiative, Workforce Development, and Microenterprise programs are similar functions that are being moved from the Bureau of Housing to the Portland Development Commission during the current fiscal year. Responsibility for promoting and selecting Sheltered Market firms could be moved to an office with similar goals, such as the Office of Human Relations or the Diversity Development/Affirmative Action Office within the Office of Management and Finance.

In our survey of other cities, we obtained detailed information on 16 cities with programs that serve some combination of MBE, WBE, and/or ESBs. Of the 16 cities, only 2 cities placed their program in the city's procurement office. On the other hand, 7 cities placed their program in the economic development department and 3 cities placed their program in the human relations/human rights/equal opportunity office.

**Focus of Sheltered
Market Program
unclear**

The ordinance establishing the Sheltered Market Program states, “the City needs to foster competition, achieve lower prices and remedy the disparity found by the (1996 disparity) Study as soon as possible.” As discussed earlier, it appears that competition within the Sheltered Market Program has been reduced due to a decline in program participation, which could result in higher bids. In addition, the Bureau does not track Sheltered Market graduates to determine whether or not they stay in business as prime contractors and thereby increase the number of competitive contractors in the marketplace.

As far as remedying disparities identified in the 1996 disparity study, it is not clear if the claimed disparity actually existed, or if the Sheltered Market Program was designed to address disparities in contracting. The adopting ordinance said that the program was intended, among other purposes, to remedy the disparity found in the awarding of contracts by the City of Portland to prime contractors. Exhibit B to the ordinance contained data intended to demonstrate such a disparity. However, the 1996 disparity study did not include a disparity analysis of Portland’s prime contracts. The study’s consultant concluded, “Because capacity issues are substantial for large contracts (over \$500,000), the disparity analysis has been restricted to contracts under that dollar limit.” Thus, the consultant did not perform a disparity analysis of Portland’s prime contracts, many of which exceeded \$500,000 in value. Moreover, the study’s disparity analysis specific to the City of Portland was deemed unreliable because of errors found in Portland’s subcontractor utilization data.

While the adopting ordinance indicated that the Sheltered Market Program was intended to rectify a contracting disparity, the program also includes emerging small businesses, many of which are owned by people from groups with no identified disparity. As discussed in the subsequent pages, over half of program’s contracting dollars went to emerging small businesses owned by Caucasian males, rather than to minority- or women-owned businesses.

Following is a summary of the consortium-wide disparities identified in the 1996 disparity study and a breakout by ethnicity of contracts awarded to Sheltered Market firms during the twelve year history of the program.

Figure 3 1996 Oregon Regional Consortium Disparity Study
 Consortium-wide disparities in the number and dollar value of construction contracts under \$500,000 – by ethnicity*

Dollar value of construction contracts awarded

Ethnicity	Percent of avail. contractors	Percent of all dollars	Statistically significant negative disparity?
African Americans	3.75%	2.38%	Yes
Asian Americans	1.69%	3.55%	No
Hispanic Americans	4.07%	4.28%	No
Native Americans	2.16%	1.45%	No
Caucasian Females	11.51%	12.58%	No
Caucasian Males	76.82%	75.82%	No

Number of construction contracts awarded

Ethnicity	Percent of avail. contractors	Percent of all contracts	Statistically significant negative disparity?
African Americans	3.75%	1.91%	Yes
Asian Americans	1.69%	1.63%	No
Hispanic Americans	4.07%	2.79%	Yes
Native Americans	2.16%	2.28%	No
Caucasian Females	11.51%	10.25%	Yes**
Caucasian Males	76.82%	81.14%	No

Source: 1996 Oregon Regional Consortium Disparity Study, Executive Summary, pages 41-46.

* The data presented in this table is for all jurisdictions participating in the regional consortium, except Portland. Portland's contractor utilization data contained inaccuracies and was deemed unreliable by the consultant who performed the study.

** Page 42 of the 1996 disparity study's executive summary stated that only African Americans and Hispanic Americans had statistically significant disparities in the number of contracts awarded to them. However, the corresponding table on page 44 of the study indicated that the negative disparity for Caucasian females was also statistically significant.

The 1996 disparity study showed a statistically significant disparity in both the number and dollar value of construction contracts awarded to African Americans, compared to their availability in the marketplace. Hispanic Americans had a statistically significant disparity in the number of construction contracts awarded to them, but received more than their expected amount of contract dollars. Caucasian females also may have had a statistically significant disparity in the number of contracts awarded to them (the disparity study contained conflicting information on this); however, Caucasian females also received more than their expected amount of construction contract dollars, according to the study (see Figure 3).

As shown in Figure 4, firms owned by African Americans received 11 percent of the dollar value of contracts issued under the Sheltered Market Program since its inception in 1997. On the other hand, 51 percent of the dollar value of Sheltered Market contracts was awarded to Caucasian males, who were not shown to have a statistically significant disparity in the number or dollar value of construction contracts awarded to them. (See Appendix A for a year-by-year breakout of Sheltered Market contracts awarded since the program's inception.)

Figure 4 Sheltered Market contracts awarded by the City of Portland – by ethnicity (FY 1997-98 through FY 2008-09)

Ethnicity	Number of Contracts	Total Dollar Value	Percent of Contracts	Percent of Dollars
African Americans*	24	\$1,548,175	14%	11%
Asian Americans	2	\$129,550	1%	1%
Hispanic Americans	16	\$1,223,195	10%	9%
Native Americans	5	\$413,082	3%	3%
Caucasian Females	36	\$3,384,959	22%	25%
Caucasian Males	84	\$6,989,444	50%	51%
12-Year Total	167	\$13,688,405	100%	100%

Source: Data provided by the Bureau of Purchases.

* Found to have a statistically significant disparity in both the number and dollar value of construction contracts awarded to them, compared to their availability in the marketplace, according to the 1996 Oregon Regional Consortium Disparity Study.

**Disparity study
outdated**

The validity of the Sheltered Market Program appears uncertain because the data obtained for the 1996 disparity study was collected between 1991 and 1994, and is now over 15 years old. Many experts indicate that, to be current and valid, disparity study data should be no more than five years old. A 2006 report on disparity studies presented to the U.S. Commission of Civil Rights recommended that “States and localities must discard disparity studies conducted using data that is more than five years old.” The City of Portland has placed itself at risk by continuing to direct construction contracts to minorities and women without obtaining up-to-date evidence of contracting disparities caused by discrimination.

The City, together with the Portland Development Commission, has entered into an \$831,000 contract to have a second disparity study completed in 2010. Managers in the Bureau of Purchases told us the new study will provide an update to the 1996 study and will show “how far we have come” in terms of discrimination and disparities. However, we caution that some national experts have stated that disparity studies have largely been failures and have been rejected by the courts. George R. La Noue, PhD and director of the Project on Civil Rights and Public Contracts at the University of Maryland (and advisor to the City of Portland on the 1996 disparity study), was quoted in a report to the U.S. Commission on Civil Rights entitled *Disparity Studies as Evidence of Discrimination in Federal Contracting*, as follows:

“In determining whether discrimination exists and, if so, what is its source and what a narrowly tailored remedy would be, disparity studies have largely been failures. They have often been rejected by courts and have been criticized by scholars and objective government examinations.” (page 23)

Our research also indicates that remedies to discrimination should be: (1) limited to racial and ethnic groups for which evidence of discrimination exists, (2) limited to eradicating discrimination within the jurisdiction, and (3) focused on the forms of discrimination identified. In addition, the jurisdiction needs to keep detailed program data and track progress in achieving parity for the targeted minorities. Experts warn of the possible negative effects of an unjustified outreach program, including:

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- it may build general resentment in the industry,
 - it could stigmatize minority enterprises as not capable of winning contracts without special preferences,
 - awards may be unfair to the non-minority firms, and
 - any false claims of discrimination could contribute to racial polarization and suppress interest in searching for race neutral programs that may create new opportunities.

If the City is going to rely on disparity studies – including the new study in 2010 – to demonstrate the need to increase minority and women participation, it should shift the focus of the Sheltered Market Program to those groups with statistically significant disparities and the specific forms of discrimination identified (e.g., barriers to getting loans or bonds). In addition, the City will need to make sure it maintains accurate and reliable contractor utilization data, closely track progress in achieving parity where significant disparities are shown to exist, and update the studies on a regular basis.

Another alternative would be to open the Sheltered Market Program to certified emerging small businesses only. Minority- and women-owned businesses would still benefit from the program because many MBEs and WBEs are also certified as emerging small businesses (ESBs), or could easily become certified as ESBs. The City would thus avoid the cost and difficulties associated with disparity studies, yet still extend services to minorities and women.

Conclusions and Recommendations

The Sheltered Market Program has successfully directed contracts to minority-owned, women-owned, and emerging small businesses, and has provided participants with training and technical assistance. However, firms are not required to accept assistance or develop necessary skills before bidding and working on City construction projects. As a result, some participants are awarded projects they are not prepared to manage successfully, which negatively impacts the cost and timeliness of City construction projects.

The Bureau of Purchases does not do an adequate job of tracking and reporting on program performance, or of monitoring participant compliance with program requirements. City project managers

and inspectors are placed in the awkward position of both assisting Sheltered Market contractors and holding them accountable for performance. The Bureau of Purchases shares this dilemma.

The upcoming disparity study should provide City Council with up-to-date information on construction contracting disparities and on the forms of discrimination that led to these disparities. The new study offers Council the opportunity to clarify the purpose and focus of the Sheltered Market Program, and to ensure that needed operational improvements are adopted in order to make the program more successful. As it approaches this important crossroad, we recommend that City Council:

- 1. Move responsibility for the Sheltered Market Program to a bureau, or bureaus, that are separate and independent from the Bureau of Purchases.**
- 2. Ensure that a more systematic strategy is adopted for developing the skills of Sheltered Market contractors.**
- 3. Ensure that better systems are developed for tracking and reporting program performance and for monitoring contractor compliance with program requirements.**
- 4. Use the new disparity study as an opportunity to clarify the purpose and focus of the Sheltered Market Program – whether it is intended to rectify specific disparities and the forms of discrimination associated with those disparities, or whether it is intended to help all emerging small businesses, including those owned by women and minorities. Regardless of the focus Council selects, it must ensure that the program’s goals are clear to participating contractors and the public, and that progress in achieving the stated goals is tracked and reported.**

Objectives, scope and methodology

The first objective of this audit was to evaluate the City's basis for the Sheltered Market Program. To achieve this objective, we conducted research into constitutional and case law, obtained expert opinions, and reviewed national reports issued on disparity studies and affirmative action programs. Among others, we reviewed the 2006 report from the U.S. Commission on Civil Rights entitled "Disparity Studies as Evidence of Discrimination." In addition, we obtained information on other cities with various combinations of MBE, WBE, and ESB outreach programs.

We reviewed the Executive Summary of the 1996 Oregon Regional Consortium Disparity Study and the City of Portland's Fair Contracting and Employment Strategy adopted in 1997. However, we did not evaluate the 1996 disparity study for its reliability or accuracy. We interviewed Bureau of Purchases personnel and reviewed various program-related documents to gain an understanding of the structure and activities of the Sheltered Market Program. In addition, we interviewed responsible City personnel to obtain their views on the basis for the program.

The second objective of this audit was to evaluate the performance of the Sheltered Market Program, including the accomplishment of program goals, monitoring compliance with program requirements, processes for selecting and qualifying program participants, and contractor development activities. We interviewed Outside Services personnel and reviewed program files and records, including available performance data, records of recruitment and selection of program participants, and documentation of training and assistance provided to participants by technical consultants.

To understand the program's contractor development process, we interviewed selected Sheltered Market firms and business consultants hired by the Bureau of Purchases to provide assistance to program participants. We also selected 13 current and former Sheltered Market participants and reviewed their program application and pre-qualification files to evaluate their compliance with program requirements.

We interviewed construction contract administrators and project managers from the five City bureaus that participate in the Sheltered Market Program, namely the Bureau of Water, the Bureau of Transportation, the Bureau of Parks and Recreation, the Bureau of Environmental Services, and the Facilities Services Division. We examined several Sheltered Market contracts that were identified by administrators and project managers from City bureaus that typify recurring problems with Sheltered Market contracts. We interviewed the project managers of these selected contracts and reviewed related contract files. We also contacted the Housing Authority of Portland, Multnomah County, and the Portland Development Commission, but found that these agencies currently have little or no involvement in the program.

We did not review as part of this audit other City M/W/ESB programs, such as the Good Faith Effort Program, the Technical Assistance Program, and the Workforce Training and Hiring Program. Some of the issues we have discussed in this report may also impact these other M/W/ESB programs. We will consider scheduling an audit of these other programs in our future audit planning.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX A

Sheltered Market Contracts by Ethnicity FY 1997-98 through FY 2008-09

Sheltered Market contracts by ethnicity

	FY 1997-98		FY 1998-99		FY 1999-00		FY 2000-01	
	No. of contracts	%	No. of contracts	%	No. of contracts	%	No. of contracts	%
African American	2	17%	2	7%	5	33%	2	20%
Asian American	0	0%	0	0%	0	0%	0	0%
Hispanic American	1	8%	2	7%	1	7%	0	0%
Native American	0	0%	1	4%	2	13%	0	0%
Caucasian Female	4	33%	11	39%	2	13%	4	40%
Caucasian Male	5	42%	12	43%	5	33%	4	40%
TOTAL	12	100%	28	100%	15	100%	10	100%
	Dollar amount	%	Dollar amount	%	Dollar amount	%	Dollar amount	%
African American	\$133,303	15%	\$184,516	5%	\$458,711	31%	\$170,048	15%
Asian American	\$0	0%	\$0	0%	\$0	0%	\$0	0%
Hispanic American	\$150,000	17%	\$207,615	5%	\$117,820	8%	\$0	0%
Native American	\$0	0%	\$121,811	3%	\$116,796	8%	\$0	0%
Caucasian Female	\$342,144	39%	\$997,989	26%	\$274,643	18%	\$501,789	43%
Caucasian Male	\$261,463	29%	\$2,364,135	61%	\$525,030	35%	\$483,045	42%
TOTAL	\$886,910	100%	\$3,876,066	100%	\$1,493,000	100%	\$1,154,882	100%
	FY 2001-02		FY 2002-03		FY 2003-04		FY 2004-05	
	No. of contracts	%	No. of contracts	%	No. of contracts	%	No. of contracts	%
African American	2	22%	0	0%	0	0%	0	0%
Asian American	1	11%	0	0%	0	0%	0	0%
Hispanic American	0	0%	0	0%	0	0%	0	0%
Native American	0	0%	0	0%	1	33%	0	0%
Caucasian Female	1	11%	2	20%	0	0%	1	25%
Caucasian Male	5	56%	8	80%	2	67%	3	75%
TOTAL	9	100%	10	100%	3	100%	4	100%
	Dollar amount	%	Dollar amount	%	Dollar amount	%	Dollar amount	%
African American	\$212,363	25%	\$0	0%	\$0	0%	\$0	0%
Asian American	\$73,200	9%	\$0	0%	\$0	0%	\$0	0%
Hispanic American	\$0	0%	\$0	0%	\$0	0%	\$0	0%
Native American	\$0	0%	\$0	0%	\$74,475	27%	\$0	0%
Caucasian Female	\$77,861	9%	\$166,288	19%	\$0	0%	\$128,500	24%
Caucasian Male	\$475,313	57%	\$695,101	81%	\$202,588	73%	\$403,860	76%
TOTAL	\$838,737	100%	\$861,389	100%	\$277,063	100%	\$532,360	100%

Sheltered Market contracts by ethnicity

	FY 2005-06		FY 2006-07		FY 2007-08		FY 2008-09		TOTAL	
	No. of contracts	%	No. of contracts	%	No. of contracts	%	No. of contracts	%	No. of contracts	%
African American	0	0%	6	26%	0	0%	5	14%	24	14%
Asian American	0	0%	1	4%	0	0%	0	0%	2	1%
Hispanic American	1	50%	4	17%	2	13%	5	14%	16	10%
Native American	0	0%	0	0%	0	0%	1	3%	5	3%
Caucasian Female	1	50%	3	13%	4	25%	3	9%	36	22%
Caucasian Male	0	0%	9	39%	10	63%	21	60%	84	50%
TOTAL	2	100%	23	100%	16	100%	35	100%	167	100%
	Dollar amount	%	Dollar amount	%	Dollar amount	%	Dollar amount	%	Dollar amount	%
African American	\$0	0%	\$164,752	14%	\$0	0%	\$224,482	14%	\$1,548,175	11%
Asian American	\$0	0%	\$56,350	5%	\$0	0%	\$0	0%	\$129,550	1%
Hispanic American	\$119,467	46%	\$207,417	18%	\$112,976	15%	\$307,900	19%	\$1,223,195	9%
Native American	\$0	0%	\$0	0%	\$0	0%	\$100,000	6%	\$413,082	3%
Caucasian Female	\$138,974	54%	\$180,300	16%	\$322,372	42%	\$254,099	16%	\$3,384,959	25%
Caucasian Male	\$0	0%	\$540,705	47%	\$328,215	43%	\$709,989	44%	\$6,989,444	51%
TOTAL	\$258,441	100%	\$1,149,524	100%	\$763,563	100%	\$1,596,470	100%	\$13,688,405	100%

Source: Data provided by the Bureau of Purchases.

RESPONSES TO THE AUDIT



CITY OF PORTLAND
OFFICE OF MANAGEMENT AND FINANCE

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DATE: December 7, 2009

TO: LaVonne Griffin-Valade, City Auditor

FROM: Ken Rust, Chief Administrative Officer *KLR*
Jeff Baer, Director, Bureau of Internal Business Services *JB*

SUBJECT: Response to Sheltered Market Program Audit

Thank you for the opportunity to respond to your audit of the City's Sheltered Market Program. Programs designed to provide contracting opportunities to small businesses, and in particular to those who have been historically disadvantaged, are very important to the City and are reflected in the various programs that have been adopted over the years including the Fair Contracting and Employment Strategy. As noted in your audit, the Sheltered Market Program (SMP) has provided minority-owned, women-owned and emerging small businesses opportunities to compete exclusively with other SMP firms on City construction projects, and to do so while complying with state and federal law.

Your audit points out in several areas that the original disparity study that was used as the basis to establish the SMP was outdated. However, it should be noted that in 2007 the City Attorney's Office advised the Bureau of Purchases (now Procurement Services within the Bureau of Internal Business Services) about the need to update the findings of the 1996 Disparity Study. City Council approved funding in the FY2008-09 budget and efforts to develop the Scope of Work and issue a competitive Request for Proposal have been completed. In July of this year City Council awarded a contract to BBC Research and Consulting to conduct the City's disparity study with an expected project completion date of October 2010.

With any program, and especially those that balance complex socio-economic and constitutional legal issues with policy goals and objectives, there are areas for improvement. We agree with the audit recommendations for adopting a more systematic strategy for developing contractor skills, better reporting on program performance and contractor compliance with program requirements. In fact, a system has been implemented to ensure contractors perform at least 50% of the work as the prime contractor as well as including a process to align the technical assistance provided by the City to business assessment/plan recommendations. We appreciate that the audit recognized the recent improvements in the SMP resulting in a significant increase in contracts awarded to SMP firms.

We do, however, disagree with the audit recommendation that the SMP conflicts with Procurement Services goals and responsibilities and that it should be moved to a separate, independent bureau or bureaus. The audit suggests splitting up the program, with responsibility for SMP training and

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assistance moved to the Portland Housing Bureau or to PDC and assigning the selection of SMP firms to the Office of Human Relations. We do not believe that these recommendations are logical because the proposed assignments do not align with the mission statements of these organizations. For example the mission of the Housing Bureau primarily focuses on making "Portland a more livable city for all by bringing low-income people and community resources together." It would be incorrect to assume that SMP firms fall into low income categories or that they only work on residential housing projects. Additionally PDC does not oversee city construction projects so it would not make sense to move the SMP to an organization that is primarily the economic development arm of the City. Keeping the program intact and within Procurement Services allows the program coordinator to work closely with the construction buying staff. We believe that this results in significant synergistic benefits that could not be replicated by splitting up and moving the SMP to another City bureau or office.

It should also be noted that on page 19 the audit report incorrectly refers to a recommendation from Procurement Services focused review study. The focused review study's recommendation was not to eliminate the Outside Services group, but rather to integrate the work that the group does into the procurement workgroups already established within Procurement Services.

We appreciate the opportunity to respond and will look forward to seeing the results of the 2009 Disparity Study to further develop and establish contracting policies around these important socio-economic areas.



CITY OF
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OFFICE OF CITY ATTORNEY

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December 17, 2009

INTEROFFICE MEMORANDUM

TO: LaVonne Griffin-Valade
City Auditor

FROM: Linda Meng
City Attorney 

SUBJECT: Response to Sheltered Market Program Audit

Thank you for the opportunity to respond to your audit of the City's Sheltered Market Program.

Our office believes it would be helpful for understanding Sheltered Market Program to provide additional legal background of the program. You noted on page 4: "The disparity study found that minority- and women-owned businesses were subject to discrimination in the regional construction industry." However, because the City of Portland did not have sufficient, accurate subcontracting data available, it was not possible for the Disparity Study to determine whether the City of Portland itself had statistically significant disparities sufficient to support a race-based plan of affirmative action in contracting. Nonetheless, the regional data and the anecdotal evidence of past and present discrimination in contracting faced by minority contractors gathered in the Disparity Study were highly suggestive of barriers to full participation by minority contractors. Because the United States Supreme Court in *Croson* required a strong evidentiary showing of discrimination in contracting (including substantial evidence of a statistically significant disparity) for a race-based affirmative action plan, the City Attorney's Office concluded that a race-based contracting program utilizing race as a factor in contract award decisions was not legally supportable. Accordingly, the City Attorney's Office advised against adoption of such a program.

The City Attorney's Office and the City Council did conclude at that time that the regional disparities and the anecdotal evidence of discrimination found by the disparity study were sufficient to support a program that was race-conscious in one limited way. The Sheltered Market Program was designed so that all contracting decisions were race neutral: Race was and is not a factor in the award of contracts among the pool of Sheltered Market participants. The



LaVonne Griffin-Valade
December 17, 2009
Page 2

only race-conscious aspect of the program is that one of the three ways to qualify to participate in the program (by being a certified minority business enterprise) is race-conscious. However, there are also two race-neutral means to enter the program (by being a WBE or an ESB). Accordingly, based upon the recommendations of the Disparity Study, the City Attorney's Office advised that a Sheltered Market Program targeted to minority business enterprises, emerging small businesses and women-owned business enterprises could serve the purposes of removing barriers to full participation in City contracting by all of these businesses, as well as affording minority business enterprises a leg up through their participation in the program in an effort to address the suspected (but not proven) racial disparities in City contracting.

As you are aware, we have advised of the need to update the Disparity Study and the City Council funded a new study to be completed in October 2010.

LM:ks

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Sheltered Market Program: Need for clearer focus and stronger management

Report #379. January 2010

Audit Team Members: Doug Norman
Alexandra Fercak
Katherine Mason

This report is intended to promote the best possible management of public resources. This and other audit reports produced by the Audit Services Division are available for viewing on the web at: www.portlandonline.com/auditor/auditservices. Printed copies can be obtained by contacting the Audit Services Division.

LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

City of Portland 2009 Resident Survey Results (#380A, November 2009)

Federal Stimulus: Portland well-positioned to receive funds and meet requirements (#387, September 2009)

Fraud Reporting: Clarification of process and training needed (#374, September 2009)

Clean Air: City enforces parking laws to improve air quality (#381, August 2009)

