

Laguna Honda Hospital Rebuild: LHH Lessons Unlearned Impacts All Bond-Financed Projects

by Patrick Monette-Shaw

Have any lessons been learned from the rebuild of Laguna Honda Hospital (LHH)? Or will LHH rebuild mistakes be repeated on other City construction projects — like San Francisco General Hospital — because LHH’s lessons weren’t learned?

When LHH prematurely hosts its black-tie dinner tentatively scheduled for June 24, and holds its gala ribbon cutting ceremony on June 26 at 1:00 p.m. — it will actually open several months later somewhere between August and October, if then — there will be plenty of oohing and aahing over its new artwork, and the look-and-feel of LHH’s new digs.

But lurking inside is a sordid story of cost overruns and construction problems; the project wasn’t managed by either gold standard of “on time” or “within budget.”

Taxpayers should remember when they ooh and aah that the project is two years behind schedule and \$183.4 million (47%) over budget. What went wrong?

The answer involves “change orders” — changes introduced after construction plans and specifications were completed. Change orders include those: 1) Necessary to resolve and correct *errors* made during design; 2) Necessary to resolve and correct *omissions* due to a lack of information that should have been considered during design; 3) Resulting from unforeseen site conditions encountered during construction; 4) Involving client- or owner-initiated requests to add, change, or delete scope to the project after design was completed; 5) Necessary to comply with construction codes revised after completion of design and the issued permits; or 6) Issued to incorporate cost savings.

A public records request inquiring about LHH’s change orders reveals, remarkably, that LHH disingenuously claims only \$71.6 million (39%) of the \$183.4 million project budget overrun was caused by change orders. The City’s response may wrongly allocate cost overruns between change orders vs. other costs.

Of the \$71.6 million, the City claims \$7.9 million (11.1%) are change orders to correct “errors” made during design. Isn’t that a lot of errors by whoever drew the plans, or who performed plan-checking?

The City claims \$10.5 million (14.2%) of the \$71.6 million are change orders to correct “omissions” during design. Between correcting design errors and omissions, this represents 25% — totaling \$18.4 million — of the change orders the City admits to.

But 25% due to errors and omissions appears excessive, since the City hired an independent firm in 2003 to perform review of drawings for inconsistencies. A 2005 City document noted a Commissioning Agent had been hired, contractors were to perform “constructability reviews” during bidding, and Turner Construction was performing aggressive reviews hoping to mitigate potential change orders that Turner projected in 2005 might reach \$11 million. How did we get from \$11 million to \$71.6 million in change orders, and an overall cost overrun of \$183.4 million, in just four short years?



Shortly following excavation, the Health Commission was told in June 2004 of a \$25 million cost overrun; in five short years, overruns skyrocketed to \$183.4 million, largely due to “change orders.” Where was the CGOBOC?

***San Francisco’s Citizen’s General
Obligation Bond Oversight Committee
has never discussed publicly
LHH’s cost overruns by the
various change order categories.
Nor has the CGOBOC discussed
whether LHH’s “design-build” contracting
actually led to increased change orders
to correct design errors and omissions
potentially introduced by subcontractors.***

In its response, the City attributes nearly \$44 million (61.4%) of the \$71.6 million in change orders to unforeseen site conditions discovered during construction. Among this \$44 million, the City claimed \$30.3 million was due to “extended overhead costs for the contracting team related to the delays to the schedule.” Overhead costs related to resequencing of work should probably not have been attributed to site conditions, but attributed to other categories — such as resequencing of work due to errors, omissions, or owner-requested changes. When the \$30.3 million of overhead costs are reallocated, changes due to actual site conditions drop to \$13.7 million, only 19.1% of change orders.

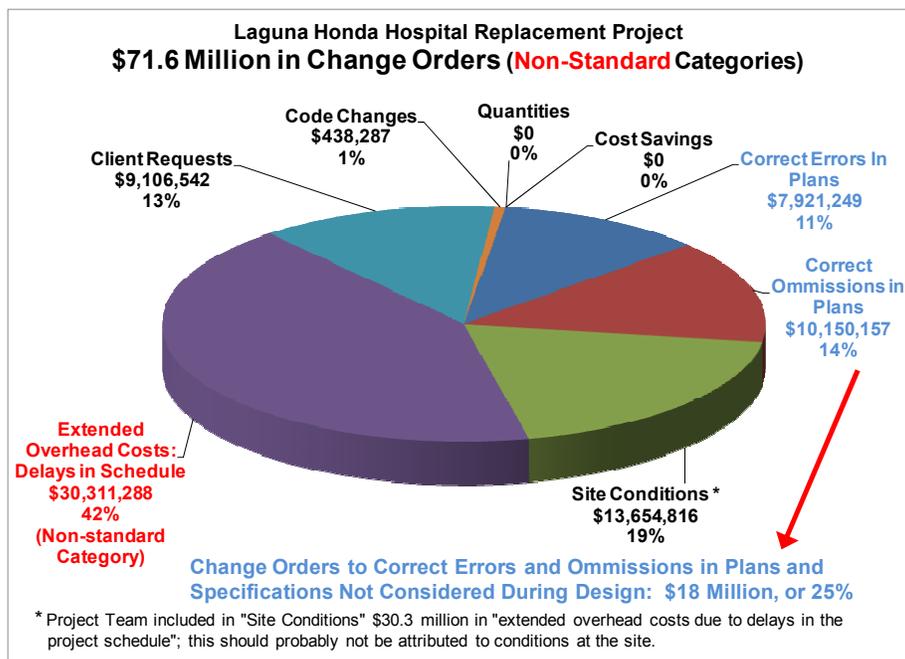
The City claims merely \$9.1 million (12.7%) of the \$71.6 million in change orders were requests made by the client or owner. While a significant amount, this is likely very under-estimated, since LHH is known to have placed a large number of owner-initiated changes, and continues doing so.

Remarkably, the City’s response showed zero change orders to incorporate cost savings. Did LHH’s “design-build” contracting approach — introduced during the 2004 bidding phase — really result in no cost-saving changes?

The City claimed cost savings related to so-called “value engineering” incorporated in 2004 was included in the project’s May 2005 revised budget. A report issued to the Citizens’ General Obligation Bond Oversight Committee (CGOBOC) five years ago acknowledges \$4.4 million savings due to value-engineering, then reports delays to the project’s schedule rapidly increased bids by \$3.4 million — a \$1 million savings, at best. “Value engineering” changes were eliminated by continuing project escalation costs that remain on-going.

So what does the City attribute the remaining \$111.8 million in “non-change order” budget increases to?

The City creatively asserts an increase of \$20.5 million to remodel administrative wings of the current main building hasn’t involved change orders. Shouldn’t that have been charged to unforeseen site conditions, or design errors and omissions? The City claims another \$19 million of the total overrun is due to “staffing increases,” but much of the increased staffing is thought necessary to process change orders, redesign building plans, and resequence work. Surely staffing increases can be attributed to the various change order categories, particularly to client-initiated requests.



The City simply describes \$81.2 million — 44% of LHH’s \$183.4 million overrun — as “initial escalation impacts,” without acknowledging that deleted or added scope resulting from escalation had to be requested as client-requested change orders. In December 2008, the City initially reported \$206.3 million in escalation; how did “initial escalation” drop somehow to only \$81.2 million by March 2009?

Another \$9 million is attributed to scope deleted in March 2009 — but as a negative number that should have been added (pushing the overrun from \$183 million to \$192 million), which should probably be charged as a client-requested change order *deletion*. Mysteriously, the City didn’t include another \$17 million of scope deleted during Budget Revision 14 in March 2008. At minimum, there has been at least \$26 million in scope *deleted* from the initial \$401 million project budget that should have been reported as client-requested deletions — and the City expects us to believe that only \$9.1 million in client-requested change orders to add, change, *and* delete scope has occurred, when a minimum of \$26 million has already been deleted?

As recently as March 2, 2010, the Health Commission was informed of additional owner-requested changes, including adding bed-pan washers in patient rooms, modifying nurse call units to accommodate bed-exit alarms, and converting 13 storage rooms into laundry rooms to accommodate patient’s laundry needs.

Since the CGOBOC first began holding hearings on the LHH replacement project, CGOBOC has never conducted a meaningful analysis of LHH’s change orders or discussed publicly LHH’s cost overruns by the various change order categories.

Nor has the CGOBOC discussed whether LHH's "design-build" contracting has actually increased change orders to correct design errors and omissions potentially introduced by subcontractors. Project reports to the CGOBOC present great detail about how much of a project's budget has been encumbered, but almost nothing about change orders. How can anything be learned if the CGOBOC simply evades conducting change order reviews?

On April 8, the CGOBOC presented a skimpy 11-page annual report for 2009 to the Board of Supervisors Government Audit and Oversight Committee concerning a number of bond-financed projects — including the LHH bond, SFGH rebuild bond, Branch Libraries bond, and two Recreation and Park bonds. All CGOBOC could muster reporting about the LHH bond was "[we're] disappointed with the overall circumstances concerning the Laguna Honda Hospital replacement Program. ... and a cost nearly double the ... amount approved by the voters somewhat dampens enthusiasm for the new Laguna Hospital."

That's it? Disappointment and dampened enthusiasm?

There's not one word anywhere in CGOBOC's 11-page annual report about change orders affecting any other bond-financed projects, despite the fact that the Department of Public Works is thought to be tracking six or seven change order categories for capital improvement projects in an internal database. Why isn't DPW sharing all change order analyses with CGOBOC?

Construction industry project-delivery tools like "construction-manager at risk," "value engineering," "design-build" contracting, "constructability reviews," and "commissioning agents" — tools touted for bringing projects in on time and within budget — all appear to have failed miserably on the LHH Replacement Project.

As I asked in my February column, what is it going to take for City officials to provide accountability about the LHH rebuild — and other bond-financed projects — in a truly transparent and timely manner? How many other City-sponsored capital improvement projects face the same types of cost overruns because change order accountability lessons from the LHH rebuild haven't been learned?

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Update:

After this article was submitted for publication, the Citizens' General Obligation Bond Oversight Committee heard an update from the LHH Replacement Project during CGOBOC's April 22 meeting. As a result of written testimony I had submitted in advance of the meeting, CGOBOC Committee Member Dick Morten pointedly asked the LHH Replacement Project's project manager, John Thomas, to comment on whether the "value engineering" approach to contracting in 2004 had worked, and whether the "construction-manager-at-risk approach that had warded Turner Construction the general manager contract had worked.

To both questions, Mr. Thomas responded "No," admitting for the first time that neither approach had worked, or worked well. It's long past time for the Department of Public Works and other City departments to abandon their use of "creative" contracting methods that don't work, and may have contributed (however inadvertently) to the massive cost overruns on the LHH replacement project, and perhaps on other City capital construction projects.

Additionally, CGOBOC's new Chairperson, Abraham Simmons, and several members of CGOBOC appear to have taken seriously my suggestion that CGOBOC review the various change order categories on each bond-financed project quarterly, in order to monitor (along with encumbrances of funds) and identify early whether change orders are leading to project cost overruns.

Both John Thomas' startling admission, and the CGOBOC's willingness to review change order data, are important victories in increasing accountability and transparency over the City's capital infrastructure bond-financed construction projects.