[Their name],

We were lucky to get some strong proposals in on this and we deeply appreciate all the info from your side — and for your patience. After a lot of careful thought, we have decided to go with another firm for this project. While we certainly have no doubt about the superior quality of your team or that you could deliver on this skillfully we decided to use this project to expand our bench of development partners and, since this is part experiment for us, this was a good opportunity to do that.  
  
We’d really like to continue talking with you about future projects we have coming up this year. I definitely look forward to collaborating in the future.  
  
Thanks again for your help and your time.

[Your name]