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**STATEMENT OF:
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(INSTALLATIONS AND ENVIRONMENT)**



**BEFORE THE SUBCOMMITTEE ON
MILITARY CONSTRUCTION
OF THE HOUSE APPROPRIATIONS COMMITTEE**

HOUSING PRIVATIZATION

INTRODUCTION

Mr. Chairman and distinguished members of this Subcommittee, this is my first opportunity to testify before this subcommittee on the topic of The Military Housing Privatization Initiative. It is a pleasure to be here. At the outset, I want to express the Department's appreciation for the support of Congress last year in extending our military housing privatization authorities to 2012. This action will significantly enhance our ability to maintain program momentum. One of the Administration's top priorities is supporting and strengthening our military. Included in that support is a strong commitment by the President and Secretary Rumsfeld to improving the quality of life for our men and women of the armed forces. When Secretary Rumsfeld recently testified before Congress on the FY 2003 budget request he stated: We're competing with the private sector for the best young people in our country. We can't simply count on their patriotism and their willingness to sacrifice alone.... I ask that we continue to keep faith with our active and reserve component members, as well as our retirees. Sustaining the quality of life of our people is crucial to recruiting, crucial to retention, and especially crucial to our readiness to fight. But more important, it's the right thing to do for our heroes who, this very minute, are serving in harm's way, defending our freedom. They're the practitioners of joint war-fighting and the creators of transformation. They make things happen and should always be our top priority.

Privatizing military housing is a priority for the President and the Secretary and is an integral part of the Administration's Management Plan and is crucial to providing a decent quality of life for our Service members. During our visit to Fort Campbell, Kentucky, last November, the President made it very clear to me that inadequate housing for our Service members and their families is unacceptable.

STATUS OF MILITARY FAMILY HOUSING

Approximately 60 percent of DoD's family housing units worldwide, totaling over 168,000 units, are considered inadequate. Fixing this problem using only traditional military construction would take over 20 years and cost as much as \$16 billion. The Department's family housing construction budget request of \$1.3 billion, up from the \$1.1 billion requested in FY 2002, supports traditional approaches to military housing as well as privatization to implement the Department's plan to renovate, replace or privatize over 35,000 housing units in FY 2003 alone. We expect to have privatized a cumulative total of over 60,000 units by the end of FY 2003.

DOD INITIATIVE FOR IMPROVING HOUSING

The Department is aggressively pursuing a comprehensive initiative to improve the living conditions of all Service members, thereby enhancing their quality of life.

1. Increasing housing allowances to eliminate the out-of-pocket costs paid by Service members for private sector housing in the United States -- Higher allowances will help members who live off base to afford good quality housing and improve their options. The FY 2003 President's Budget request includes necessary funding to continue lowering Service members housing out-of-pocket costs for those members living off-base from 11.3 percent today to 7.5 percent in 2003. We plan to eliminate all out-of-pocket housing expenses by 2005.

2. Increasing reliance upon the private sector through privatization -- Higher allowances will increase and enhance housing privatization, further improving Service member's access to quality housing. Higher allowances will increase the income available to private sector developers, facilitating increases in the quantity and quality of privatized housing. The FY 2003 President's budget continues the acceleration started in FY 2002 to address most of the inadequate housing by FY 2007, three years earlier than our initial goal of 2010.

3. Maintaining military construction funding -- The combination of increased allowances and continued use of privatization will permit more efficient use of current military construction funding for family housing. Increased availability of quality private sector options will ease pressure on on-base housing, reduce the need to maintain old, costly housing, and allow us to spend our operations and maintenance funding more wisely. There will remain some locations where military construction may be the preferred alternative, for example where privatization is not financially feasible.

THE HOUSING PRIVATIZATION PROGRAM

Recognizing the inadequacy of military construction alone as a method of eliminating inadequate housing, Congress, in 1996 provided the department with significant new authorities to use private sector expertise and capital to accelerate improvement of government owned housing and helping the department eliminate a serious shortage of quality affordable housing. Using these newly extended privatization authorities, we can continue with confidence to develop projects that provide higher quality housing, both on and off base, faster and at less cost than traditional methods. Our policy requires that privatization yields at least three times the amount of housing as traditional military construction for the same amount of appropriated dollars. As our recent projects have demonstrated, this leveraging is normally much higher. The projects awarded thus far reflect a leverage ratio of almost 8:1. Tapping this demonstrated leveraging potential through continued use of housing privatization has allowed us to provide houses that would have required budgeting as much as \$800 million over the same time frame, had we used our traditional MilCon approach. This approach allows us to fix housing supporting military members much more quickly and still less expensive over the life of the projects taking into account the allowances that will be paid to our Service members.

At roughly this point last year, the housing privatization program had awarded 10 projects in 5 years, producing about 7,000 privatization units. Only one year later, we have awarded a cumulative total of 16 projects producing about 25,000 privatized units. The six privatization projects awarded over the last year has more than tripled the number of units already privatized. We believe that we have been able to accelerate the program because of the dedicated efforts of the Military Departments, the Administration's support and funding, the increased buy-in of installation stakeholders and Congressional interest and support.

We have strived to implement this program in a manner that ensures high quality construction and renovation of military family housing in an efficient manner. Some of these efforts have included: diligent scrutiny and selection of developers, sound legal documents, strong oversight and monitoring procedures, and inclusion of protections to the government in the terms and conditions of agreements with private developers. Our experience thus far has verified our expectations:

" Privatization speeds fixing our inadequate housing in comparison to the traditional MilCon process.

" The private sector provides a high quality product. According to tenant surveys administered by the Services at our housing projects, Service members and their families are pleased with privatized housing.

" The program has momentum and Service project privatization plans are moving forward.

We want to continue this acceleration and marry the President and Secretary's sense of urgency here with the focus, the discipline, the energy and the creativity of the private sector to strengthen this program. We are gaining experience and moving out of the pilot stage of this program.

As we gain momentum in family housing, we are also exploring the possibility of privatizing barracks. Barracks privatization raises some new issues not seen in family housing privatization. Two significant ones are: 1) degree of control in terms of assignment of personnel and operation of the barracks is much greater. Balancing this control while allowing the private developer enough autonomy to run the project is a challenge. And; 2) the allowance for unaccompanied Service members is targeted for a one-bedroom apartment. Our barracks standard is based on two people sharing a two-bedroom apartment (referred to as 1+1); this discrepancy between income stream and product needs to be resolved. The Department will continue to work these issues with the Services and hope to present some pilot proposals for your consideration later this year.

AWARDED PROJECTS

To date the Congress has approved sixteen housing privatization projects (fourteen projects are awarded and two projects - Fort Meade and Fort Lewis will be entering final document closeout in April-May 2002). Highlights of recent projects are noted below:

" Fort Meade, Maryland -- The Army is using the investment authority to privatize a total of 3,170 family housing units on base at Fort Meade, Maryland. The project includes the conveyance of 2,862 existing units. The initial development plan includes the demolition of 2,440 existing homes and the construction of approximately 2,748 new homes. Additionally, the project includes construction of two community centers, neighborhood recreational facilities and comprehensive landscaping. A \$426 million project, the Army is investing only its existing housing stock. No capital investment of

appropriated dollars was required. Congress approved the project award in December 2001-final transition of the base is expected in May 2002.

" Fort Lewis, Washington -- The Army is using the investment authority to privatize 3,982 units on base at Fort Lewis near Seattle. The Fort Lewis project involves the construction and management of 345 new units, and the renovation/reconstruction, maintenance and management of 3,637 units. This project will result in a total of 3,982 privatized units. The project includes improvements in roads, landscaping, bike paths and playgrounds. In addition, four village community centers will be constructed, including a base-wide community center with adjoining soccer complex. A \$321.1 million project, the Army is only investing its existing housing stock here as well. Congress approved the project award in October 2001-final transition of the base is expected in April 2002.

" Naval Complex South Texas, Texas -- The Navy used the investment authority to privatize 661 units near Naval Air Station Corpus Christi and Naval Station Ingleside near the Corpus Christi area. The Naval Complex South Texas project will include a total of 661 homes including 546 new duplex design homes and renovation of existing units. An \$82 million project, was awarded in February 2002.

" Fort Hood, Texas -- The Army used the investment authority to privatize 5,912 units on Fort Hood near Killen, Texas. The Government will convey 5,622 existing units and out-lease the underlying land as part of this initiative. The project involves a partnership to construct 973 new housing units and renovate 4,939 housing units (a net increase of 290 units). Over 4,000 units will be replaced during the life of the project. Additionally, the revitalization includes two new community centers and comprehensive landscaping for both existing and new neighborhoods. A \$266.2 million project, the leverage is approximately 5.2:1 comparing equivalent military construction to the scored cost. The project was awarded in November 2001, and is under construction.

" Naval Complex New Orleans, Louisiana -- The Navy used the investment authority to privatize 935 units near New Orleans. This project encompasses two locations, and includes privatization of 200 existing, government owned units at Naval Support activity and 216 existing, government owned units at Naval Air Station-Joint Reserve Base New Orleans. Additionally, the project includes the construction of 519 new high quality 2, 3 and 4 bedroom townhouse units and associated improvements. A \$79.8 million project, the leverage is approximately 3.4:1 comparing equivalent military construction to the scored cost. The project was awarded in October 2001, and is under construction.

" Naval Complex San Diego, California -- The Navy used the investment authority to privatize 3,248 units at Naval Complex San Diego, near San Diego, California. This project involves the privatization of 2,660 existing family housing units in the San Diego region, renovations on 1,058 of the privatized units, demolition and replacement of 812 units, and construction of 588 new deficit reduction units. The 2,660 existing units to be privatized are located in 19 Government housing neighborhoods throughout San Diego. A \$262 million project, the leverage is approximately 13:1 comparing equivalent military construction to the scored cost. The project was awarded in August 2001, and initial new construction is projected for completion in May, 2002.

" Elmendorf, AFB, Alaska --The Air Force project involves the design, construction, and management of 828 units at Elmendorf AFB, near Anchorage, Alaska. The project includes 420 new units, 200 renovated units, and 208 previously renovated unit. This is a \$100.5 million project. The leverage is approximately 5.8:1 comparing equivalent military construction to the scored cost. The project was awarded in March 2001, and military residents are now occupying new homes.

" Naval Station Everett II, Washington -- The Navy entered into a limited partnership with a private developer to obtain 288 new units at NS Everett II off base in Everett, Washington for 30 years. This is a \$42.3 million project. The leverage for this project is 3:1 comparing equivalent military construction to the scored cost. The project was awarded in December 2000, and military residents are now occupying new homes.

" Marine Corps Base - Camp Pendleton, California (Phase 1) -- The Marine's project involves the replacement of 312 and renovation of 200 existing units and the construction of 200 new units. This is an \$83.3 million project; the leverage for this project is 4.5:1 comparing equivalent military construction to the scored cost. The project was awarded in November 2000, and military residents are now occupying new homes.

" Naval Air Station Kingsville II, Texas -- The Navy entered into a limited partnership with a private developer to obtain 150 new units for 30 years. This is a \$14.5 million project. The leverage for this project is 3:1 comparing equivalent military construction to the scored cost. The project was awarded in November 2000, and military residents are now occupying

new homes.

In FY 2003, the Department plans to award projects that will result in the production of over 35,000 units-for a cumulative program total of over 60,000 units by FY 2003. Our most recent data reflects over 25 projects in/or pending solicitation with over 40,000 units; and 30 projects in the planning stage with over 47,000 units. This continued acceleration of the privatization program puts the Department in a good position to address most of the inadequate family housing by 2007. All of the Services have identified possible housing privatization projects in accordance with their family housing master plans, submitted to Congress last July, 2001. All the Services, with the exception of the Air Force, meet the 2007 goal. The Air Force currently meets the goal in 2010, a three year advance in the program since last year. (The Department's upcoming Military Housing Privatization solicited projects, and planned projects are provided on the attached tables).

| PROJECTS in/or pending SOLICITATION | | |
|--|---------------|------------------------------------|
| Installation | Scope | Deal Closing/Contract Award |
| Goodfellow AFB, TX | 298 | April-2002 |
| Kirtland AFB, NM | 1,164 | May-2002 |
| Wright-Patterson, OH | 1,536 | June-2002 |
| Stewart Army Subpost, NY | 171 | July-2002 |
| Patrick AFB, FL | 552 | August-2002 |
| Hickam AFB, HI | 1,356 | November-2002 |
| Fort Hamilton, NY | 436 | November-2002 |
| Buckley AFB, CO | 201 | December-2002 |
| Moody AFB, GA | 606 | January-2003 |
| Ft. Bragg, NC | 5,578 | January-2003 |
| Hill AFB, UT | 1,116 | January-2003 |
| MCAS Beaufort/MCD Parris Island, SC TX | 1,665 | January-2003 |
| Offutt AFB,NE | 2,229 | January-2003 |
| Little Rock AFB, AR | 1,535 | January-2003 |
| Presidio of Monterey/NPSC Monterey, CA | 2,268 | February-2003 |
| Picatinny Arsenal, NJ | 116 | February-2003 |
| Ft Campbell, KY | 5,470 | March-2003 |
| Dover AFB, DE | 450 | April-2003 |
| Ft Irwin,CA | 2,052 | April-2003 |
| Moffett Federal Airfield, CA | 690 | April-2003 |
| Camp Parks, CA | 13 | April-2003 |
| Ft. Belvoir, VA | 2,070 | April-2003 |
| Walter Reed Medical Ctr, DC | 221 | April-2003 |
| Ft. Stewart/Hunter, GA | 3,939 | May-2003 |
| Ft. Detrick, MD | 155 | June-2003 |
| Ft. Eustis/Story, VA | 1,115 | June-2003 |
| Ft. Monroe, VA | TBD | June-2003 |
| Ft. Polk, LA | 3,648 | July-2003 |
| Total | 48,463 | |
| PROJECTS in PLANNING | | |
| Installation | Scope | Deal Closing/Contract Award |
| Altus AFB, OK | 978 | December-2004 |

| | | |
|------------------------------------|---------------|----------------|
| Nellis AFB, NV | 1,313 | February-2003 |
| Andrews AFB, MD | 115 | TBD |
| McGuire AFB/Ft Dix, NJ | 1,882 | September-2003 |
| Beale AFB, CA | 1,444 | November-2002 |
| Hurlburt AFB, FL | 330 | December-2003 |
| Lackland AFB, TX (II) | 564 | December-2003 |
| Barksdale AFB, LA | 432 | April-2003 |
| Elmendorf AFB, AK (II) | 624 | July-2003 |
| Langley AFB, VA | 1,268 | June-2003 |
| F.E. Warren AFB, WY | 265 | June-2003 |
| Hanscom AFB, MA | 687 | June-2004 |
| Maxwell AFB, AL | 614 | December-2004 |
| Shaw AFB, SC | 1,704 | April-2003 |
| Cannon AFB, NM | 1,205 | TBD |
| Northwest Region (Long Island) NY | 564 | August-2003 |
| NAWC Lakehurst, NJ | 212 | August-2003 |
| NSA Mid-South Millington, TN | 626 | August-2003 |
| NC San Diego, CA (Phase 2) | 4,981 | TBD |
| Oahu Regional, HI | 1,978 | June-2003 |
| MCB Camp Pendleton, CA (Phase 2) | 3,595 | September-2003 |
| Hampton Roads, VA Region | 593 | TBD |
| Ft. Shafter/Schofield Barracks, HI | 8,178 | October-2003 |
| Ft. Leonard Wood, MO | 2,472 | April-2004 |
| Ft. Sam Houston, TX | 935 | July-2004 |
| Ft. Bliss, TX | 2,763 | September-2004 |
| Ft. Benning, GA | 4,109 | November-2004 |
| Redstone Arsenal, AL | 625 | January-2005 |
| Ft. Rucker, AL | 1,516 | May -2005 |
| Ft. Gordon, GA | 876 | October-2005 |
| Total | 47,448 | |

USE OF AUTHORITIES

As I mentioned earlier, our initial projects have considerably increased our understanding of how best to employ the authorities. I have included a table that lists the twelve basic authorities with descriptions of their benefits and budget impacts

| Authority | Section | Description | Benefit | Budget Impact | Where Used |
|--------------------|---------|--|--|--|--|
| <i>Direct Loan</i> | 2873 | DoD can provide a direct government loan | Brings additional financing at concessional interest rates | 30% - 100% of loan amount, depending on terms. | Lackland AFB, TX Dyess AFB, TX Robins AFB, GA Kingsville NAS, TX MCB Camp Pendleton, CA Elmendorf AFB, AK |

| | | | | | |
|--|------|--|--|--|---|
| <i>Investments (Joint Venture)</i> | 2875 | DoD can provide equity investment | DoD obtains an interest in the business entity that does the project | Cash equity contribution is scored at 100% upfront | Everett, WA Corpus Christi, TX Everett II, WA Kingsville NAS, TX Ft Hood, TX; NC South Texas, TX NC San Diego, CA NC New Orleans, LA; NC South Texas, TX |
| <i>Conveyance or Lease of Land and Units</i> | 2878 | DoD may transfer ownership of units and land by fee simple conveyance or long-term lease | Transfer of ownership secures private sector financing Cash flow from units allows for additional private sector debt to fill financing gap | None | Lackland AFB, TX - land lease MCB Camp Pendleton, CA - conveyance of units and land lease Robins AFB, GA - conveyance of units and land lease Ft. Carson, CO & Elmendorf AFB, AK- conveyance of units and land lease, Ft Hood, TX; NC San Diego, CA; NC New Orleans, LA; NC South Texas, TX; Ft Meade, MD; Ft Lewis, WA |
| <i>Differential Lease</i> | 2877 | DoD can provide an | Brings additional financing by | Net present value of DLPs over life | Everett, WA |

| | | | | | |
|-------------------------------------|------|---|--|---|--|
| <i>Payments (DLP)</i> | | additional rental payment directly to the developer | increasing rental income | of contract | Corpus Christi, TX; NC San Diego, CA |
| <i>Loan Guarantees</i> | 2873 | DoD can guaranty private sector loan | Lowers interest rate Ensures availability of private sector financing | 4% - 7% of loan amount for limited base closure guarantee | Ft. Carson, CO Lackland AFB, TX Robins AFB, GA Elmendorf AFB, TX |
| <i>Unit Size and Type</i> | 2888 | DoD can build to local standards | Results in more cost-effective development | None | Lackland AFB, TX Ft. Carson, CO Everett, WA Corpus Christi, TX Everett II, WA Kingsville, NAS, TX MCB Camp Pendleton, CA Dyess AFB, TX Robins AFB, GA Elmendorf AFB, TX Ft Lewis, WA |
| <i>Ancillary Support Facilities</i> | 2881 | DoD can allow private sector to construct ancillary support facilities for the housing development (e.g., play areas, jogging trails) | Enhances quality of life for military tenants. | None | Lackland AFB, TX Ft. Carson, CO Everett, WA Corpus Christi, TX Everett II, WA Kingsville, NAS, |

| | | | | | |
|------------------------------|------|--|---|--|---|
| | | | | | TX MCB Camp Pendleton, CA Dyess AFB, TX Robins AFB, GA Elmendorf AFB, AK, NC San Diego, CA; Ft Hood, TX; NC New Orleans, LA; NC South Texas, TX; Ft Lewis, WA; Ft Meade, MD |
| <i>Payments by Allotment</i> | 2882 | DoD can require tenants to pay rents through allotments | Improves financing by minimizing uncertainty of late payments and non-payment of rent | None | Lackland AFB, TX Ft. Carson, CO Everett II, WA Kingsville, NAS, TX MCB Camp Pendleton, CA Dyess AFB, TX Elmendorf AFB, TX |
| <i>Assignment of Members</i> | 2882 | DoD can assign members to privatized housing | Could support occupancy during downsizing or deployment | Net present value of rental stream generated by assigned members | None |
| <i>Build to Lease</i> | 2874 | DoD can contract for the private sector to build and maintain units for lease by DoD | Central payment by DoD in stead of tenant - analogous to 801 Program | Net present value of lease payments | None |
| <i>Rental Guaranty</i> | 2876 | DoD can guaranty occupancy or rental income. | Enhances the availability of private sector financing - | Net present value of rental payments | None |

| | | | | | |
|-----------------------|------|--|--|---|------|
| | | | analogous to 802 Program | | |
| <i>Interim Leases</i> | 2879 | DoD can lease privatized units for an interim period | Technical tool to enable occupancy prior to conveyance | Net present value of lease payments during interim period | None |

Use of these authorities must be understood in context of how housing privatization projects are structured. When developing housing privatization projects, experience has shown that the total funds available combining developer equity and available private sector financing is normally less than the total development cost. This dynamic creates a development gap, which must be filled by various uses of our authorities. Since the cost of using these authorities (scoring) is much less than the cost of budgeting for military construction, significant leveraging of funds is realized. However, we recognize that allowances must be paid to the Service members who did not draw allowances when occupying government housing. We then compare all costs over the life of the project to ensure that individual privatization projects are less costly than its military construction equivalent. Life cycle analyses have shown privatization to be less costly than military construction for all projects so far. Our most recent data reflects a life cycle advantage for privatization of 15 percent.

LESSONS LEARNED

The Department has also learned a number of other lessons concerning how to best structure housing privatization projects from our initial solicitations. We have taken great care to ensure that the viability of the projects is protected from downturns in the project revenues while simultaneously making sure that the project shared in any increases in revenue. Many of our projects employ a "lockbox" concept, which prioritizes the use of project income to ensure the government's interests are provided for before the developer sees any profits. All operating expenses, reserves, and debt service are paid before the developer receives any money.

We have also learned from our first on base projects at Fort Carson and Lackland Air Force Base that long-term ground leases and contract terms enhance the quality of the projects. Private sector financing dictates long-term mortgages based partly on the magnitude of the loans, which require stretching out the repayment term to allow project revenues to meet debt service requirements. Additionally, by requiring projects to be maintained for 50 years, we have seen innovative solutions proposed by the private sector in our first solicitations, which reduce risk of project failure. In fact requiring the private developer to commit to providing quality affordable housing for long terms is responsible stewardship of the upfront government contribution to these projects.

POST AWARD MANAGEMENT

Because decent, safe and affordable housing is such an important component to our Service members lives, we are taking steps to ensure that the privatization projects we have already awarded remain fiscally and physically in good shape for the long term. To that end we oversee these projects through our internal oversight document called the Program Evaluation Plan (PeP) that provides key information on the Service's portfolio management. The PeP is a formal mechanism to analyze and monitor privatization projects on an ongoing operational basis. PeP data is collected and reviewed semi-annually.

The PeP includes information on project deal structure selection, project performance and program execution. From the two data submissions received thus far from the Services our data shows there are no overall portfolio areas of concern at this stage of the program. Major financial highlights from our PeP data include:

- " The current Debt Coverage Ratio for all applicable projects is 1.20 or greater.
- " There have been no loan late payments, loan defaults, loan modifications, or changes in project ownership or management.
- " For the bases where some transferred or newly constructed MHPI units are available to military family member tenants, the occupancy for all privatized units is 95 percent or better.

Other major programmatic improvement suggestions are captured by the PeP data and have been adapted for use in our projects. These include:

- " Inclusion of senior enlisted and other local staff in a privatization effort.
- " Improvements in the contracting mechanism--for Request for Proposal/Request for Qualifications.

" Continued refinements to business structures based on project specifics.

In addition, the PeP requires the Services to regularly report on customer satisfaction. Standard surveys are being developed individually and cooperatively by the Services. To date only 40 percent of the reporting installations (4 out of 10) have any of their privatized units occupied, but the initial responses and informal feedback from the existing privatized tenants has been very positive.

The PeP information gathered so far has been provided to the Service Assistant Secretary teams working privatization. My office will hold a one-day information session with the Services portfolio managers in the Washington area in Spring 2002, to review in greater detail the kind of information we are gleaning from the PeP. We will review the areas for improvements and changes in future projects. In particular, we want to improve the deal structures to provide effective private sector incentives while maintaining sufficient government protections. Overall, this session is intended to sharpen the Department's post-award management skills.

NEXT STEPS

In terms of next steps, the Department plans to build on our earlier privatization successes by simplifying the process, accelerating project execution, and institutionalizing best practices in the Services deals with the private sector. We want to better define for the private sector what kind of privatization projects we want and communicate our program goals and needs. Additionally, we want to increase private sector competition and innovation.

We also looking at ways to incorporate improvements suggested by our private sector partners:

- " Increase the pace at which projects are released for solicitation
- " Reduce the amount of time from the issuance of a solicitation to contract award
- " Develop and standardized streamlined solicitation processes
- " Combine Privatization of Bachelor quarters with Family Housing

CONCLUSION

In closing Mr. Chairman, I would like to sincerely thank you, Ranking Member Olver, and the Subcommittee for your strong support of our military housing privatization program. I look forward to working with you in the future.