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STATEMENT OF

MR. PHILIP W. GRONE
PRINCIPAL ASSISTANT DEPUTY UNDER SECRETARY OF DEFENSE
(INSTALLATIONS AND ENVIRONMENT)

BEFORE THE SUBCOMMITTEE ON
MILITARY CONSTRUCTION
OF THE HOUSE APPROPRIATIONS COMMITTEE

INTRODUCTION

Mr. Chairman and distinguished members of this Subcommittee, I appreciate the opportunity to discuss the Military Housing Privatization Initiative. This initiative truly transforms the quality of life for our Service members and their families. I am pleased to provide you with testimony on how we are using the legislative tools you have provided us - to improve - real time - our Service member's daily lives and housing options.

SUPPORTING OUR PEOPLE

Our main priority is to support Service members and their families engaged in national security efforts and the war on terrorism. Our Service members deserve the best possible living and the best possible working conditions. At the outset of this Administration, the President identified military housing, including housing privatization as key component of the Presidential Management Initiative. When President Bush visited Fort Hood, Texas last November he stated:

"In this time of war, our military is facing greater sacrifice; our men and women are enduring long separations...Those who risk their lives for our liberty deserve to be fairly paid and fairly treated."

Sustaining the quality of life of our people is crucial to recruitment, retention, readiness and morale. The FY 2005 President's Budget requests \$4.2 billion in new budget authority to construct, operate and maintain military family housing, an increase of over \$200 million from FY 2004. This funding request allows the Department on to stay on track to eliminate nearly all its inadequate military family housing units by FY 2007, with complete elimination in FY 2009. The Department's family housing construction budget request of \$1.6 billion, up from the \$1.2 billion requested in FY 2004, supports traditional approaches to military housing as well as privatization

STATUS OF THE PROGRAM

In January 2001, the Department had approximately 180,000 inadequate family housing units (out of a total of 300,000 housing units worldwide). At the end of fiscal year 2003, through housing privatization and our military construction program, we have reduced the number of inadequate units to about 120,000 (out of a total 256,000 housing units worldwide). By the end of FY 2005, we will have reduced the number of inadequate housing units to roughly 61,000. This number will continue to come down as we pursue the Secretary's goal of eliminating nearly all inadequate housing by 2007, using three major tools:

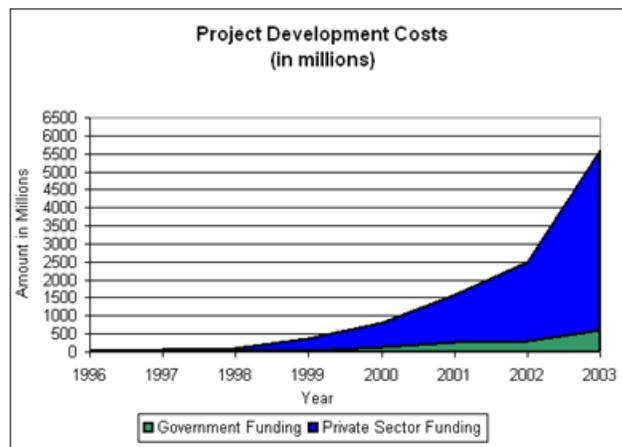
1. Increasing reliance upon the private sector through privatization – Eliminating out-of-pocket expenses is good for military personnel, but also serves to strengthen the financial basis of the housing privatization program by increasing the income stream associated with housing projects. The FY 2005 President's budget continues the acceleration started at the beginning of this Administration in FY 2001 to address nearly all the inadequate housing by FY 2007. Our current plans are to privatize a cumulative total of over 136,000 units by the end of FY 2005. We project by the end of FY 2005 the Department will privatize over of 59% of its existing Continental United States and territories (CONUS) housing inventory. Our current plan is to privatize the majority of our CONUS family housing.

2. 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 overseas locations where military construction may be the only alternative, or, for example where privatization is not financially feasible.

3. 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 2005 President's Budget request includes necessary funding to ensure that the typical Service member living in the private sector will have zero out-of-pocket housing expenses. This is a remarkable achievement that has come about as a result of the Administration's continued commitment to supporting our Service members, along with Congress' strong backing.

THE HOUSING PRIVATIZATION PROGRAM

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 provide quality affordable housing for military families. Using these privatization authorities, we can 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. Recent projects have demonstrated that such leveraging of appropriations is normally much higher. The awarded projects we have analyzed thus far reflect a calculated average leverage ratio is over 11:1 for all projects combined. Tapping this demonstrated leveraging potential through our awarded projects to date has allowed the Department, in partnership with the private sector, to provide houses that would have otherwise required budgeting over \$6.2 Billion for those awarded projects, using our traditional Military Construction approach (see Chart below).



Privatization allows us to fix our family housing much more quickly and is still less expensive over the life of the projects when taking into account the allowances that will be paid to our service members.

At the start of this Administration, in early 2001, the housing privatization program authorities had been in effect for roughly four and one-half years, and over that time period nine projects were awarded, totaling about 10,000 privatization units. In FY 2004, three years later, the program has clearly benefited from the Services experience and knowledge combined with greater Senior leadership support. As of February 2004, the Department has awarded a cumulative total of 27 projects producing over 55,081 privatized units. This reflects an acceleration of nine projects a year. This program continues to improve and gain momentum and we expect that by the end of FY 2005, the Department will have privatized about 136,000 housing units. This is a huge transformation of our military family housing. We believe that we have been able to accelerate the program due to a variety of factors – the dedicated efforts of the Military Departments, the Administration's support and funding, the increased buy-in of installation stakeholders, private sector confidence that the program will continue, and finally Congressional interest and support.

We are implementing this program in a manner that encourages 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 Military Construction process.
- The private sector provides a high quality product. According to tenant surveys administered annually by most of the Services at our housing projects, Service members and their families are pleased with privatized housing – in particular, those living in new and renovated homes. They remarked about the high quality of the new housing and the ease of requesting home maintenance/repair and the timeliness of the service provided.
- The program has momentum and Service's are now planning to privatize the majority of their family housing inventory in the Continental United States and territor

Upcoming Awards

We believe our housing privatization efforts have now achieved identified success, with installation commanders and Service members welcoming privatization efforts to revitalize their family housing. Our accelerated schedule includes approximately seven more housing privatization project award/closings in the March-April 2004 timeframe. These projects include:

- Fort Irwin/Moffett Field/Parks Reserve, California (3,052 housing units)
- Little Rock Air Force Base, Arkansas (1,200 housing units)
- Buckley Air Force Base, Georgia (351 housing units)
- Hickam Air Force Base, Hawaii (1,356 housing units)
- Hanscom Air Force Base, Massachusetts (784 housing units)
- Navy - Hawaii Regional (Phase I), Hawaii (1,948 housing units)
- Offutt Air Force Base, Nebraska (2,255 housing units)

Future Awards

In addition to these projects, we plan 17 more awards in fiscal year 2004 and over 25 awards in 2005 – bringing our cumulative total end of year FY 2005 to about 136,000 units privatized. We project by the end of FY 2005 the Department will have privatized about 59% of its existing CONUS inventory. We currently plan to privatize a cumulative total of over 160,000 family housing units in CONUS by the end of fiscal years 2007. As noted earlier, we plan to meet the 2007 goal, with complete elimination of all inadequate housing by 2009.

Status of Privatized Projects

To date, out of our 27 awarded projects, 10 have completed their Initial Development Phase – which is the time period we use in each project to eliminate all inadequate housing. A completed Initial Development Phase means all renovation and new construction, including the deficit build out (additional new housing) has been completed. The Initial Development Phase usually last 3-4 years for most Air Force, Navy and Marine projects and can extend to 5-10 years for larger Army projects. The 10 completed projects include:

- Naval Air Station Corpus Christi/Kingsville I, Texas (404 units privatized)
- Naval Station Everett I, Washington (185 units privatized)
- Lackland Air Force Base, Texas (420 units privatized)
- Dyess Air Force Base, Texas (402 units privatized)
- Robins Air Force Base, Georgia (670 units privatized)
- Naval Station Everett II, Washington (288 units privatized)
- Marine Corps Base Camp Pendleton, California (712 units privatized)
- Naval Air Station Kingsville II, Texas (150 units privatized)
- Elmendorf Air Force Base, Alaska (828 units privatized)

- Naval Air Station New Orleans, Louisiana (935 units privatized)

During fiscal year 2005, we expect several other bases to complete their renovations and construction or be close to completion, including the first Army project, Fort Carson, Colorado. In addition, renovations and new construction is ongoing at our other privatization projects.

Post Award Management

Because decent, affordable and quality housing is such an important component to our Service member and their families lives, we are taking steps to ensure that the privatization projects we have already awarded remain fiscally and physically in good shape – and are well managed – 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 for analyzing and monitoring privatization projects on an ongoing operational basis. PEP data is collected from each Service and reviewed semi-annually.

The PEP includes information on project deal structure, project performance and program execution. The information is tracked from one period to the next in order to ascertain any development trends and/or potential issues with individual projects. In addition, the Department uses this information to compare and contrast projects across the Services. On a quarterly basis, the Department is also engaging the Services in formal meetings in order to share lessons learned, identify potential areas for improvement and training, as needed. Currently the program reviews have focused on developer performance and financial solvency; project occupancy rates, tenant satisfaction, debt coverage ratio, and renovation and construction progress.

Since implementation of the PEP three years ago, the Department has continued to refine the process in order to ensure the quality of information collected is relevant and timely. Based on the performance of each project to date, we are confident in reporting that the program is meeting expectations and that projects are fiscally and financially sound. As we continue to gain greater experience and knowledge, the Department recognizes that the key to continue to success will depend on a variety of factors the least of which is allowing the private sector to bring forth best practices.

Major financial highlights from our recent PEP data include:

- All projects are financially sound.
- For the 27 awarded projects there has been one change in project ownership.
- For the installations where transferred, renovated or newly constructed MHPI units are available to military family member tenants, the occupancy for the majority of our privatized units is in the range of 90-100 percent, although three projects are in the 82-87% level, and one project is at 70 percent.

In addition, the PEP requires the Services to regularly report on customer satisfaction. Standard surveys are used by the Services. Of the 20 installations included in our last PEP reporting installations, the responses and informal feedback we've received from the privatized tenants has been positive.

We use the PEP to 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.

USE OF AUTHORITIES

Our 27 projects have considerably increased our understanding of how best to employ the Military Housing Privatization Initiative authorities. 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 for the 20 projects we've

analyzed thus far, a life cycle advantage for privatization of about 10-15 percent.

IMPROVED HOUSING REQUIREMENTS PROCESS

We recognize that a key element in maintaining the support of the Congress and of the private sector is the ability to define adequately the housing requirement. The Department's longstanding policy is to rely primarily on the private sector for its housing needs. Currently, 60% of military families reside in private sector housing, and that number will increase as we privatize the existing inventory of housing units owned by the Military Departments. Only when the private market demonstrates that it cannot provide sufficient levels or quality of housing should we step in and provide housing either through use of the privatization authorities or through traditional military construction.

An improved housing requirements determination process, approved by the Deputy Secretary of Defense released in January 2003, combined with increased privatization, is allowing us to focus resources on maintaining the housing for which we have a verified need rather than wasting those resources duplicating private sector capabilities. The improved housing requirement process is being used by the Department to better determine the number of family housing units needed on installations to accommodate military families. It provides a solid basis for investing in housing for which there is a verified need – whether through direct investment with appropriated funds or through a privatization project.

Further, as housing out-of-pocket expenses decrease for the average member, we expect more military families will choose to live in the local community. This migration should permit the Services to better apply scarce resources to those housing units they truly need to retain. We are also concentrating on aligning the housing requirements determination process more closely with the analysis utilized to determine basic allowance for housing rates. This improves our ability to predict our housing needs and to make sound investment decisions necessary to meet the Secretary's goal to eliminate nearly all inadequate housing by 2007. The Department is aggressively pursuing a comprehensive initiative to improve and transform the living conditions of all Service members, thereby enhancing their quality of life.

PROGRAMMATIC ISSUES

The Department has achieved privatization successes by simplifying the process, accelerating project execution, and institutionalizing best practices in the Services deals with the private sector. As described earlier in the testimony, many projects require use of appropriated funds when subsidies are provided to the projects, especially as investments, loans and limited loan guarantees. The amount of such appropriated funds was limited in Section 2883 of Title 10, United States Code, to \$850 Million for military accompanied (family) housing and \$150 Million for military unaccompanied housing. Due to the rapid acceleration of the program over the last three years, we are now in position where almost 70% (about \$600 M) of the \$850 million cap has been used. We project the remaining 30% of the Cap will be used up by the beginning of FY 2005; thus impeding the full implementation of the President's Management Agenda initiative to eliminate all inadequate military family housing by 2007. We intend to work with Congress to ensure that we provide our Soldiers with good quality housing.

This recommendation to increase our budget authority has generated conceptual discussions with the Congressional Budget Office. The Congressional Budget Office has stated that the Department's housing privatization program is governmental in nature, and that the total development cost should be accounted for in the federal budget. In implementing the MHPI, DoD has ensured that "privatization" – in concept and in fact – characterizes all housing projects developed under this initiative. This commitment to private sector participation, in which the private sector accepts both the risks and rewards of developing military housing, is embodied in the five principles of privatization developed by OSD to guide the services' implementation of the MHPI:

- **Project scope and government subsidy** – The government receives the best value for its up-front contribution, a sufficiently certain scope of rental housing, and preferred occupancy at specified rents for its service members.
- **Government risk management** – The government protects its interests without participating in the day-to-day management of the project. Agreements are structured to sufficiently protect the interests of the government while minimizing both government control and liability.
- **Private sector ownership and control** – The development entity owns the property with all the

attributes, benefits, and risks of that ownership. Service members are private tenants who choose where to live and pay rent.

- **Private sector bears financial risk** – The development entity is responsible for all risks common in the market, including insuring its property against fire, flood, and other acts of God; and the development entity does not shift that liability to the government.
- **Competition** – Optimal projects are obtained through competition on price and quality for the duration of the project.

In addition, our projects are each reviewed by the Office of Management and Budget (OMB) and cash subsidies are scored in accordance with rules set up for the program in 1997. We continue to comply with OMB circulars as the program progresses.

The Department provides housing for our military families only when the local housing market is unable to do so. Our Program Evaluation Plan monitors how well housing privatization is achieving that purpose, as well as protecting other government interests such as repayment of loans we have made in the projects. We have worked hard to limit our involvement to only essential protection of the government's interest. At every step we have shifted responsibility to own and manage the housing on the private partner. We have put the risk of attracting member tenants on the private sector. By requiring service members to pay their own utilities, we have placed responsibility for usage on the resident user. We insist that day-to-day management to be handled between our tenants and the private sector landlord.

The Department recognizes that maintaining and operating family housing is not a core competency and that, historically, we have not done it well. These projects allow us to get out of those ownership responsibilities and the last thing we want to do is take them back over in the future.

I mentioned earlier that we have had one project that has had a change in ownership...at Fort Carson, Colorado. That process is instructive to those who believe our program is creating some future contingent liability for the Department. In September 2003, the parent company of the general partner (J.A. Jones Community Development) in the Fort Carson Family Housing LLC filed for Chapter 11 reorganization. Fort Carson Family Housing LLC, which runs the housing at Fort Carson with the Army as a limited partner, remained a valuable operating entity and was not part of the bankruptcy filing. However, as a part of the bankruptcy settlement, the general partner proposed to sell its interest in Fort Carson Family Housing LLC since it was a valuable asset. In November 2003, the partnership interest was sold to GMH Family Housing LLC, who became the new general partner. The Army had no involvement in this bankruptcy action except to exercise its right to approve its new general partner in Fort Carson Family Housing LLC. The project never skipped a beat and continues to provide affordable, quality housing to the military families at Fort Carson with no change in the Army's status as limited partner. I believe this example demonstrates that we have the right financial and legal structures in place to walk the fine line of maintaining private sector risk while still protecting government interests.

SCHOOLS

The FY 2004 Military Construction Appropriation Report 108-82 included Senate Appropriation Committee language which directed the Secretary of Defense to report to "Congressional defense communities...on the impact of privatization of military family housing on local school districts, and options for addressing local school requirements resulting from the privatization." We are in the process of preparing the Department's report to Congress. In addition, the General Accounting Office has been asked to prepare a follow-on report to evaluate the Department's report. We have been working closely with GAO on this issue, and have met with the Fountain – Fort Carson School District Assistant Superintendent; additionally we have conducted an on-site meeting with the Killeen Independent School District (KISD) Superintendent and his staff, who are responsible for providing Fort Hood, Texas schools. These two Local Education Districts have been very supportive and flexible in accommodating some of the student load shift/changes, and increases that our projects have caused. The Fort Carson-Fountain School Superintendent Office is dedicated to serving the installations needs; and they along with the Fort Hood privatization team and Killeen Independent School District Superintendent's Office are doing an exemplary job. We are committed to communicating the timetable for the project; the size and scope of the project, any change in scope –surplus/deficit, changes in housing locations and renovation and demolition and replacement schedule. We believe the Department has the responsibility to provide data in a consistent manner to Local Education Districts throughout the life of these

projects. In terms of future school impacts – we have instituted a rigorous housing requirement process and in most cases we do not foresee any additional projects including large deficit build-outs.

CONCLUSION

In closing Mr. Chairman, I would like to sincerely thank you, Ranking Member Edwards, and the Subcommittee for your strong support of our military housing privatization program. I look forward to working with you in the future on our legislative issues and any program improvements suggested by the Subcommittee.