

New Authorities for Military Housing

What the 1996 Military Housing Amendments Mean

The Problem. The FY 96 Defense Authorization Act, passed in January, 1996, contains a far-reaching set of amendments to existing law on buying and building homes for military families and dormitories for single soldiers. For thirty years both types were built by contractors to the government and paid for when built with government money appropriated for each individual project. This required such a large up-front payment that too few units have been built or renovated. The result is that 60% of family housing is substandard and few barracks meet the current goal of private rooms for each occupant.

A majority of the current DoD family housing stock in the United States was actually built with private funds under the Wherry program (rental guarantee) in the 1950s and the later Capehart program (government houses, but financed with mortgages taken out by an Air Force-owned corporation). Both of these programs developed problems and were terminated by 1965. In the 1980's, built-to-lease agreements under "Section 801" resulted in construction of 12,000 houses for military families. This program became unattractive when new rules on "scoring" expenditures required that the full construction cost be treated as paid by the Air Force in the first year, even though in fact the cost would be paid from 20 years of rent.

In this paper, "housing" refers to housing for either single people or families; "family housing" only to units for military families, and "dormitories" or "unaccompanied

housing" to facilities for single or otherwise unaccompanied people.

1996 and a New Beginning. The 1996 Housing Amendments contain a tool-box of new techniques for private financing and construction of houses for military families and dormitories for single people. They allow the Air Force to partner with the private sector, providing land, money, and guarantees to assure private developers of a durable and profitable investment in units intended primarily for military personnel. While there is some history of doing this for family housing, the 1996 Military Housing Amendments also make private sector partnering authorities available to build and rehabilitate unaccompanied housing. This is unprecedented, and represents a new opportunity for the private sector.

This paper summarizes the principal provisions of this new law. It follows the section numbering in the law in case you want to compare our summary with the actual text.

Key Definitions (Section 2871 of Title 10, United States Code)

Ancillary Supporting facilities. Because the Air Force buys or leases housing in quantity, small communities emerge from construction of new housing. Communities need facilities like child care centers, tot lots, community centers, and housing offices. Dormitory complexes need unit offices and dining halls. Without these "ancillary supporting facilities", the new housing would be inconvenient and ill-suited to community life. The law allows them to be included in a "housing" project, even though they obviously are not dwellings.

Construction. This term includes both new construction and rehabilitation of existing structures.

Military unaccompanied housing is housing for people without dependents, either because they are single or are assigned without their families.

BASIC PARTNERING AUTHORITIES

General Authority (Section 2872)

The new authorities in this section can be used in any combination to provide for acquisition or construction of family housing and dormitories "on or near" military bases in the United States, Puerto Rico, and United States territories and possessions (such as Guam and the Virgin islands). They are not presently available in foreign countries. There is overseas build-to-lease authority under other laws. Of course, the Air Force may continue to build, buy, or lease housing with government funds to the extent money is available.

Direct Loans and Loan Guarantees (Section 2872)

Direct Loans. The Air Force may loan money directly to a private party for use in buying or building housing to be used by military families and individuals. The terms, including repayment period and the obligations of the borrowers may be determined by the Air Force. Non-recourse financing would be permitted if the Air Force chose to offer it.

Loan Guarantees. The Air Force may guarantee loans that finance construction or purchase of housing for use by military families or individuals. The amount of the guarantee may not exceed the amount of the outstanding principal of the loan, or 80% of the value of the project, whichever is less. As with direct loans, the Air Force has broad discretion to establish the purposes and conditions of a loan guarantee. For example, a guarantee could be limited to losses due to government actions, such as future base closures, unit reassignments, or program terminations that reduce the numbers assigned to an installation. It could also include losses under additional circumstances, up to an "all-risk" guarantee.

Funding of Loans and Guarantees. For the Air Force to make a loan or guarantee one, Congress must first appropriate funds in an annual appropriation act. Section 2873 implies that an appropriation act could also provide authority for make or guarantee loans without requiring specific advance appropriations. This was a common practice until the late 1970's, but current fiscal rules make revival of "contract authority", as it was called, unlikely. Direct loans will probably require that the Air Force have the full amount available when the loan is made; even though it may be disbursed over several years. The Department of Defense is seeking approval from the Office of Management and Budget for funding loan guarantees at the anticipated rate of default. For example, if 10% of a billion dollar loan portfolio could be expected to default, \$100 million would be required in the relevant account. This, of course, would allow DoD funds to leverage \$10 worth of construction for every dollar reserved. This approval has not yet been obtained, so availability of loan guarantees in the immediate future should not be assumed.

Leasing of Housing in Advance of Construction (Section 2874)

The Air Force may contract to lease houses or dormitories to be constructed by the private sector. This is similar to the "Section 801" authority used in the 1980's. However, there is no statutory provision limiting the duration of the lease, as there was under Section 801. Either the Air Force or the owner may operate and maintain the property, as agreed in the contract.

Investments in Nongovernmental Entities (Section 2875)

This far-reaching and unprecedented provision allows the Air Force to join with private interests to build private developments for use by military families or individuals. The Air Force participation can take several forms: limited partner (but not general partner); stockholder in a corporation; or purchaser of bonds or other debt instruments.

These can be done in combination, such as a purchase of both stock and bonds.

Limitation on Value of Investment. The cash amount of an investment by the Air Force is limited to 33 1/3% of the capital cost of all projects for military housing units that the entity proposes to carry out with the investment. Where the Air Force is conveying land or facilities as part or all of its investment, the total value of the Air Force contribution is limited to 45% of the capital cost. "Capital cost" is measured by the total amount of costs included in the basis of the housing for Federal income tax purposes.

This limitation is purely financial and is not a limitation on corporate governance. For

example, a single-project corporation plans to pay for 20% of the project with equity and 80% with borrowing. A government investment of 10% of the cost of the project would give it 50% of the equity, and therefore potentially 50% of the stock.

"Collateral Incentive Agreements" This complicated term refers to a simple notion; when the Air Force invests in or subsidizes a housing enterprise, it should have an agreement with the enterprise that the housing built in part with Air Force funds will actually be made available to its members. The agreement does not have to call for 100% military occupancy, only for preference for military families and individuals in the rental or purchase, depending on the type of project, of a reasonable, and negotiable, percentage of the units attributable to Air Force financial support.

Rental Guarantees (Section 2876)

The Air Force may enter into agreements with persons that acquire or construct rental property to assure occupancy of the units at specified levels, or a percentage of the rental income. The former assures that tenants will show up, but the Air Force doesn't promise to pay their rent. The latter undertakes to guarantee a specific cash flow whether or not there are tenants. It appears that these guarantees can be made only to a party that builds new housing or acquires housing it did not previously own ("acquire or construct"), and not to current owners of existing housing.

The extent to which either of these guarantees requires advance appropriations is quite

complex and dependent on the exact terms of the arrangement. In general, any deal that contemplates the government paying a guarantor in cash requires that the Air Force have funding in hand at the time the agreement is made. The amount may well be equal to the full construction cost of the project.

Subsidized Rents (Section 2877)

The Air Force may enter into agreements with owners of rental housing (including existing housing) under which the Air Force makes an additional payment over and above the rent charged the service member. This would allow the owner to receive a market level of rent while charging the service member only his or her Basic Allowance for Quarters and Variable Housing Allowance, if any. This provision applies to existing housing as well as to new housing built under the new authorities in the Military Housing Amendments.

SUPPORTING AUTHORITIES

Conveying or Leasing Air Force Land and Buildings to Construct or Rehabilitate Housing (Section 2878)

Authority to Convey or Lease. The Air Force may "convey" (sell or donate) or lease its land and buildings to a private party who will make housing available to military members. The

property can be the site for new housing, or housing on it rehabilitated. It could also be sold and the proceeds used to build housing for military people on another tract of land. This is a companion authority to Section 2875, allowing investments in private companies consisting of property instead of cash. It is not limited to investment situations, however. The property could be part of a lease and leaseback, or an outright sale or lease to a developer in which the Air Force has no financial interest.

The Property Disposal Process. This authority is required since normally government agencies cannot sell or donate their property to a selected recipient. All unused real property must be offered to providers of housing for the homeless before it can be offered to other agencies, sold or leased, under the Stewart B. McKinney Homeless Assistance Act. Then it must be offered to other government agencies for reuse. State and local governments and charitable groups have a chance to claim unwanted property. Only when all of these potential recipients have refused does property become "surplus". The General Services Administration sells surplus property to the highest bidder, which is not necessarily the recipient that the owning agency wanted the property to go to. Leasing is also limited by law and requirements on reporting to Congress.

This section, however, exempts property conveyed or leased for housing purposes under the Military Housing Amendments from the constraints of the McKinney Act and the surplus property disposal process (the Federal Property and Administrative Services Act). It is also exempt from the limits imposed by the Military Leasing Act (referred to as "Section 2667") and the fair market rent requirements of the Economy Act of 1933. Property at closing military bases cannot be conveyed or leased under this section. A different set of

laws gives priority to community redevelopment in disposing of closing bases.

Preference for Military Tenants. A key part of the consideration for a conveyance or lease must be an agreement by the private party to give a "suitable preference" to military personnel in renting housing resulting from the transaction. This need not be housing units transferred by the Air Force, or on land included in such a transfer. They may be other suitable housing units controlled by the buyer or lessee of the government property.

Interim Leases (Section 2879)

Individual units in a new or rehabilitated housing project are completed sequentially over a period of time. The government typically buys or leases the whole project when it is completed. This could leave a number of units vacant for a long time, leaving prospective military occupants in less satisfactory quarters and earning no revenue for the owner. This section allows the Air Force to enter into temporary leases pending completion of the project. These "interim" leases are on a unit-by-unit basis and must end when the project is done and is sold or leased to the Air Force. This is actually a long-standing practice, but its consistency with other laws on leased housing has been questioned. This section specifically permits interim leasing and ends the questions about it.

Ancillary Supporting Facilities (Section 2881)

These are the community facilities defined in Section 2871 and discussed under that

heading. The offices, maintenance areas, child care facilities, community centers, and dining halls that round out a community can be included in the overall purchase price or rent for a housing project. This section is needed because Congress must approve all construction. It normally authorizes each project specifically, and the terms of each authorization must be strictly followed. The Military Housing Amendments, without this provision, would allow the Air Force to buy or lease housing units only. Even shops for project maintenance workers would not be included. With this section included, the Air Force may buy a whole community when it purchases housing. It is not limited to housing units alone.

Mandatory Assignment of Members to Housing Units and Allotments of Pay to Pay Rent

(Section 2882)

Mandatory Assignment. Air Force people are entitled either to a government-furnished house (or room in a dormitory for a single person) or a cash housing allowance. The allowance is "forfeited" (not paid by the Air Force) when the person occupies government quarters. To make maximum use of government housing, individuals may be ordered to occupy it. Current law, however, does not permit the Air Force to order its people into quarters for which they have to pay rent. This section allows the Air Force to assign personnel to housing it has made arrangements for under the Military Housing Amendments. When the housing is not owned or leased by the Air Force, so that the individual must pay rent, he or she is to receive normal housing allowances. This helps the government to make good on occupancy guarantees under Section 2876. It provides security for direct loans or loan guarantees under

Section 2873 as well as for private financing. It also avoids any questions whether housing owned by an entity in which the government has invested under Section 2875 is "government-owned" or not. Under previous laws this question would be important in determining whether or not the individual was entitled to quarters allowances.

Paying Rent By Allotment. The Air Force may require members renting housing that was acquired or constructed under the Military Housing Amendments to make an allotment of pay to cover rent. "Allotments" are sums deducted from pay before the member receives his check, and are forwarded directly by wire transfer to the designated recipient. Rent by allotment saves administrative costs for the owner and also virtually assures regular monthly payments. This is an important feature for lenders as well as property managers, since it provides greater assurance of regular cash flow.

ADMINISTRATION

Department of Defense Housing Funds (Section 2883)

Separate Funds. The Department of Defense may set up two separate housing funds, one for family housing and the other for unaccompanied housing. The two cannot be mixed! Each fund consists of specific appropriations to the fund by Congress; transfers of existing housing construction appropriations; proceeds from the lease or sale of property; and income from loan interest, profits on investments, and return of invested capital. These funds are used to carry out the various activities authorized under the Military Housing Amendments, such as

buying stock, guaranteeing loans, and subsidizing rents. The funds may also be used to pay the costs of planning and executing the government's participation in contracts. Money from the funds is provided by the Secretary of Defense to the Air Force to carry out the Military Housing Amendments.

Limitation on Obligations from the Funds. The Department of Defense's potential obligations to make payments under all of the contracts entered into under the Military Housing Amendments for each type of housing cannot exceed the total amount in each respective fund. The Air Force cannot enter into a contract that would increase DoD obligations above that amount. DoD's ability to enter into contracts is also limited to the amount approved in annual Congressional appropriation acts, which may be less than the amount in the funds. The total amount committed by DoD from the funds for acquisition and construction cannot exceed \$850 million for family housing and \$150 million for unaccompanied housing. These limits can be changed by Congress in the future. Typically, they are reviewed every year.

Reports to Congress (Section 2884)

The key report required by this section is a report to the four Committee of the House and Senate concerned with military matters on each proposed contract under the Military Housing Act involving purchase or construction of housing, and each intended conveyance or lease. The report must be made at least 30 days before proposals are solicited for a contract or a parcel of property is offered for conveyance or lease. This report is in considerable detail, and receives careful scrutiny by Committee staffs and some members of Congress.

While the Air Force is legally free to proceed on the 31st day, this type of "report and wait" provision has a long history. In reality, the department waits for informal approval of each transaction before proceeding with it, even if the response takes much more than 30 days. The Air Force and the Committees may negotiate over disapproved projects, but it is unlikely that the Air Force will carry out any project over the disapproval of even one Committee.

Expiration of Authority (Section 2885)

The authority to enter into new contracts under the Military Housing Amendments expires in five years (January, 2001). Its provisions would continue to govern contracts signed before that. A year earlier, in March 2000, the Secretary of Defense is to submit a report analyzing the effectiveness of the amendments. If they have resulted in construction and rehabilitation of housing at reasonable cost, they would most likely be extended with amendments to rectify any problems that have developed in the first five years.

Limited Partnerships

An existing law, Section 2837 of Title 10, United States Code, permits the Navy to enter into limited partnerships with private developers. Section 2802 of the FY 96 Defense Authorization Act simplifies that law and extends the authority to all of the services. These limited partnerships are distinct from any that might be entered into under the Military Housing Amendments, and are financed from a separate "Defense Housing Investment

Account". The account must be capitalized with an appropriation, and partnerships cannot be entered into if there is not enough money in the account to pay the government's full obligation to the partnership. This authority expires September 30, 2000. It is not clear at this time whether the Air Force will use it or the limited partnership authority in the Military Housing Amendments for any partnership arrangements it might want to enter into.