

POINT PAPER
ON
MILITARY FAMILY HOUSING PRIVATIZATION AUTHORITIES

OVERVIEW:

The Fiscal Year 96 Defense Authorization Act (Public Law 104-106) enacted into law new authorities to allow and encourage private sector financing, ownership, operation, and maintenance of military housing (the authorities are codified at 10 U.S.C. §§ 2871 - 2885).

The authorities are limited to a five-year test period expiring February 2001 (contracts executed under the authorities prior to its expiration date will continue to be governed by the privatization authorities throughout their terms--up to 50 years).

The authorities extend to both military family housing and unaccompanied housing. However, the Air Force has not undertaken implementation of the authorities relative to unaccompanied housing.

The new authorities are several and may be used in "any combination" in order to provide for the acquisition or construction by private persons of family housing units on or near military installations within the United States and its territories and possessions. (10 U.S.C. § 2872)

The law permits "ancillary supporting facilities" such as child care centers, tot lots, community centers, housing offices, and other similar facilities for the support of military housing to be included in housing projects under the privatization authorities. (As a matter of Air Force policy, ancillary facilities do not include MWR fund generating activities.)

Both the Senate (section 2804 of S. 1059, FY 2000 NDAA) and the House (section 2803 of H. 1401) are proposing amendments to the privatization authorities to prohibit the development of ancillary support facilities which would compete directly with DECA, AAFES or any NAF instrumentality generating MWR funds (the legislation is aimed at preventing commercial developments in combination with housing projects that would erode DECA, AAFES or NAF revenues).

BASIC AUTHORITIES:

Direct Loans and Loan Guarantees (§ 2873).

The Air Force may loan money directly to persons in the private sector for the acquisition or construction of military family housing.

The loan may be primary or subordinate to private-sector financing used to support a project, (i.e., a direct loan from the Air Force may be secured by a first or subordinate mortgage on the project).

The terms of a direct loan, including its repayment period and interest rate, may be set by the Air Force and help to subsidize the cost of the project by making lending available to a private developer at less than prevailing market rates of interest.

While the terms and conditions of direct loans may be structured to significantly decrease the cost of borrowing for a private developer, they must be structured in a way to reasonably ensure their repayment; there is no grant authority (e.g., a deferred balloon payment of a zero interest loan without recourse would be considered an unauthorized grant).

The Air Force may guarantee private-sector loans used to construct or acquire military family housing.

As a matter of law, the Air Force guarantee may not exceed the lesser of the outstanding principal of the loan or 80% of the value of the project.

Air Force guarantees only cover the risk of the specific governmental actions of base closure, realignment, or extended deployments. They are not "all risk" guarantees and do not underwrite losses occasioned by the inherent business risks associated with housing privatization transactions.

Loans are paid out of project-specific U.S. Treasury accounts. Before funds are obligated for a loan or loan guarantee the Air Force must transfer funds from the Family Housing Improvement Fund to the Treasury in accordance with OMB "scoring" rules.

Under OMB scoring, each housing privatization project that uses a direct loan or loan guarantee must meet the following risk or "participation" test: at least 20 percent of all resources for a project must be provided from private sources. If a project does not pass the "participation" test, the full amount of a loan or guarantee will be recorded as an obligation and must be funded prior the execution of a loan or loan guarantee.

If a project meets the "participation" test outlined above, under OMB scoring the Air Force must fund the "subsidy rate" of all loans and loan guarantees. The subsidy rate is equal to the net present value of the cost (risk) of default and interest rate subsidy (difference between Treasury rates of interest and interest rates charged to developers on project loans) over the life of the loan and loan guarantee.

It is important to note that under OMB scoring the Air Force does not necessarily have to fund the full principal amount of a guaranteed loan. This permits significant leveraging of project funds.

Leasing of Housing in Advance of Construction (§ 2874).

The Air Force may contract to lease houses to be constructed by private-sector developers (similar to old "Section 801" build-to-lease authority).

There is no limit to the duration of a lease under this section.

Under OMB scoring rules, the Air Force would need to have funds available in the Family Housing Improvement Fund equal to the present value of its entire lease payments over the life of the lease before it could enter into a lease under this section. Accordingly, OMB scoring makes the leasing authority impractical to use (the Air Force has not used this authority).

Investments in Nongovernmental Entities (§ 2875).

The Air Force is authorized to make investments in nongovernmental entities to acquire or construct housing for use by military members.

Air Force participation in nongovernmental entities can take several forms: (1) acquisition of a limited partnership interest (cannot be a general partner and therefore cannot manage project); (2) stockholder in a corporation; (3) purchaser of bonds or other debt instruments; or (4) any combination of such forms of investment.

The concept is to allow Air Force funding to fill the gap between the cost of a project and available private financing through participation in business ventures by a means that limits the Air Force's potential liability to no more than its initial investment (i.e., the dollar value of its stock, investment in a LLP or cost of debt instruments).

Consistent with policy, Air Force contributions to nongovernmental entities should be the minimum required to successfully execute a project.

By law, the cash amount of an Air Force investment in a nongovernmental entity may not exceed 33 1/3% of the capital cost of the project or projects to be carried out with the investment. If an Air Force investment includes a conveyance of land or facilities, the total value of the investment may not exceed 45 percent of the capital cost of the project or projects to be carried out with the investment.

Air Force investments in nongovernmental entities must include a "collateral incentive agreement" to ensure that a suitable preference will be afforded to military families in leasing or purchasing of a reasonable number of the housing units covered by the investment (the agreement doesn't have to provide for 100% military occupancy).

To date, the Air Force has not participated in any form of investment in a nongovernmental entity under this authority (however, AF/ILEIP reports that projects at Wright-Patterson AFB, Patrick AFB and Tinker AFB, among others, contemplate use of limited liability companies).

The Navy has experience with limited liability partnerships. The Navy entered into a 10-year limited partnership agreement in July 1996 under separate authority (P.L. 103-337, codified at 10 U.S.C. § 2837) to build and operate 404 family housing units at two locations in Texas. In March 1997, the Navy entered into a 10-year limited liability partnership agreement under 10 U.S.C. § 2837 to build and operate 185 family housing units in Everett, Washington.

SAF/GCN indicates that Navy has not elected to continue its use of limited liability partnerships because of the restrictions upon a limited partner's role in managing projects.

Rental Guarantees (§ 2876).

The Air Force may enter into agreements with private persons who acquire or construct (current owners of existing housing are not eligible) rental housing to guarantee: (1) rates of occupancy (assuring a certain number of tenants); or (2) rental income from the project (guaranteeing a specific project cash flow).

Under OMB scoring rules, the Air Force would need to have funds available in the Family Housing Improvement Fund equal to the present value of its entire guaranteed payments over the term of the agreement before it could enter into a guarantee under this section. The Air Force has not used this authority due to the scoring impact.

Differential Lease Payments (§ 2877).

The Air Force may enter into agreements with private lessors of rental housing (including existing housing) to make payments over and above the rent charged to the individual service member.

This authority enables an owner of private rental property to receive market-rate rentals while only charging service members rent equal to their Basic Allowance for Housing (BAH) (i.e., the Air Force would subsidize project rental income to bring it up to a market rate of return).

Under OMB scoring rules, the Air Force would need to have funds available in the Family Housing Improvement Fund equal to the present value of its entire differential lease payments over the term of the agreement before it could enter into an agreement under this section. The Air Force has not used this authority.

Conveyance or Lease of Existing Property and Facilities (§ 2878).

The Air Force may lease or convey military-owned real property and existing housing (including ancillary supporting facilities) to private persons who will make housing available to military members.

The lease or conveyance of military-owned real property can be for the purpose of constructing new housing or rehabilitating existing housing.

The authority also permits a lease or conveyance of military-owned real property where the proceeds are used to secure housing for military personnel on a separate tract of land (i.e., a lease or conveyance to a private party may be for purposes other than housing as long as the consideration running to the Air Force includes a preference for housing military members on another site).

Consideration for any lease or conveyance of military-owned real property under this section must include an agreement to afford a "suitable preference" to rental housing for military members and their dependents.

Property leases and conveyances under this section are exempted from the requirements of: (1) 10 U.S.C. § 2667 (usual long-term lease authority for non-excess property); (2) Federal Property and Administrative Services Act (normal surplus property disposal process); (3) Section 321 of the Economy Act (limiting leases of buildings and properties to money consideration only); and (4) the McKinney Act (statutory requirement to offer unused real property to providers of housing for the homeless).

Property on or near a military installation approved for closure cannot be conveyed or leased under this section.

The fair market value of military-owned real property and facilities will be considered in determining the limits of permissible investments under Section 2875 (c)(2), or loan guarantees under Section 2873 (b)(2).

The conveyance or lease of military-owned real property, in and of itself, has no scoring impact as long as the property or all of the proceeds from the transaction will be used to provide housing for military members and their dependents.

Interim Leases (§ 2879).

This section permits the Air Force to enter into short-term leases for housing units as units are completed during the construction or renovation phase of a project.

Interim leases allow the Air Force the benefit of completed units prior to project completion and enable developers to benefit from the early receipt of revenue from projects.

Interim leases cannot extend beyond the completion date of the project.

Unit Size and Type (§ 2880).

Exempts projects from statutory and regulatory restrictions on design and space by pay grade requirements. It allows units acquired or constructed to be built to room patterns and floor areas generally comparable to similar housing units "in the locality concerned" (i.e., market standards for rental units).

Assignment of Members to Housing Units (§ 2882).

To make the maximum use of housing secured under the privatization authorities military members may be ordered to occupy housing units.

Mandatory assignments can be used in order to discharge occupancy guarantees under § 2876 or provide security for direct loans under § 2873.

Military members assigned to privately owned housing will receive their normal housing allowances (basic allowance for housing).

The Air Force has not exercised this authority in connection with any housing project to date.

Department of Defense Housing Funds (§ 2883).

The legislation calls for the establishment of a DoD Family Housing Improvement Fund. The fund is to be financed from: (1) specific appropriations; (2) transfers from existing appropriations for the acquisition or construction of family housing; (3) proceeds from the conveyance or lease of property associated with the authorities; or (4) income derived from activities associated with the authorities.

DoD's authority to enter into contracts under the privatization authorities is limited to the amount approved in annual Congressional appropriations acts, which may be less than the total amount in the Family Housing Improvement Fund.

DoD's total potential obligations under all contracts entered into under the privatization authorities cannot exceed the total amount of the Family Housing Improvement Fund.

Reports (§ 2884).

A report on each proposed project under the privatization authorities must be submitted to the appropriate committees of Congress not later than 30 days before the date on which the Secretary issues the contract solicitation or offers the conveyance or lease.

The report shall describe the proposed contract, conveyance, or lease and the intended method of the Government's participation in the contract, conveyance, or lease and provide a justification of such method of participation.

A Congressional notification is also required after the completion of source selection and prior to award.

OTHER MAJOR CONSIDERATIONS:

Projects require environmental baseline surveys in order to determine the conditions existing on the real property subject to lease or conveyance to a private developer, compliance with the requirements of the National Environmental Policy Act (NEPA) and accurate surveys and descriptions of the subject property.

The Chief of Staff has established a "no out-of-pocket" expense policy for military family housing privatization projects. Pursuant to this policy, rent is to include 110% of the average utilities costs and cannot exceed the total housing allowance for the authorized military grade of each rental unit (e.g., the rent for a unit authorized for an E-5 must include the 110% of the average cost of utilities and cannot exceed an E-5's BAH).

Pursuant to guidance from the Deputy General Counsel for Acquisition & Logistics, "the applicability of the FAR to the use of any of these authorities depends on the specific authority used and the manner in which it is implemented." DoD/GC concluded that "the facts [of the Ft. Carson and Lackland AFB projects] permit each service to exercise discretion in choosing the legal instrument that best fits its needs."

The Air Force has adopted a non-FAR based approach for its military family housing privatization projects to date. (FAR guidance is used as the basis for the source selection process and FAR clauses implementing statutory requirements applicable to the project are incorporated into the RFP.)

The Army initially adopted a FAR based approach for its Ft. Carson project.

IMPLEMENTATION CHALLENGES:

In July 1998, the General Accounting Office issued a report entitled *Privatization Off to a Slow Start and Continued Management Attention Needed* criticizing the Services' implementation of the housing privatization authorities.

The GAO leveled a number of criticisms in reporting why, at that time, two years after the enactment of the authorities no privatization agreements had been signed. (One year later the Air Force has only concluded a single privatization agreement at Lackland AFB.)

Among other challenges, the GAO noted that: (1) privatization represents a new way of doing business for both the military and private sector (including military attorneys); (2) DoD had to develop new tools and models to assess the financial feasibility of projects; (3) new financial, contractual and legal issues needed to be resolved; and (4) the extended term of transactions, up to 50 years, creates unique challenges in ensuring contractor performance throughout the term of a project.

For JAGs the challenges are many. Privatization is an interdisciplinary legal process involving significant real property, acquisition, environmental and financial issues. While the Department has a wealth of experience in acquisition and environmental law, there isn't a dedicated training program for real estate attorneys comparable to the I.L.M programs in acquisition and environmental law, and there is next to no experience in working the financial arrangements necessary to support a large housing development. Additionally, the fact that the authorities present different options for transactions (e.g., conveyance, leasing, and investments), each of which poses its own set of legal issues, complicates importing solutions from other installations.

PROGRAM GUIDANCE:

On 15 Apr 97 HQ USAF/ILE issued Air Force implementation guidance entitled *Air Force Housing Privatization Policy and Guidance*. Among other things, this guidance details the review and approval process for housing privatization projects from the identification of potential projects through project close out. The program guidance is currently under review and revision by HQ USAF/ILEIP.