DEPARTMENT OF THE AIR FORCE
WASHINGTON DC

OFFICE OF THE GENERAL COUNSEL

June 26, 2003

MEMORANDUM FOR SAF/IE (MR. NELSON GIBBS)

FROM: SAF/GC

SUBJECT: Limitations on the Use of Housing Privatization Project Revenues

You asked for my views on whether existing law permits the use of funds generated in a housing privatization project to build, improve or benefit properties that will not be privatized. In examining this issue, we considered the background and purpose of the housing privatization authorities, the language and legislative history of the relevant statutes, the limitations on the use of military construction appropriations, in particular with respect to General Officer Quarters (GOQs) and historic properties, and the manner in which the Air Force developed and executes its privatization projects. In none the circumstances discussed in this memorandum have we identified a project where privatization resources could be used to build, improve or benefit non-privatized properties. [1]

Background:

This issue has arisen at several Air Force installations, most recently Hickam AFB, Offutt AFB, and Langley AFB. In each case the project designers have included requirements that the developer engage in some activity, e.g., the renovation of historic housing or the demolition and restoration of long vacant housing that is not part of the privatization project, affecting property that would not be privatized. This situation arises, at least in part, because the moneys that can be generated in some privatization projects seem to exceed the amount needed to address that base's requirement for housing and ancillary supporting facilities.

The Air Force Military Family Housing Privatization Initiative (MHPI):

The authority to enter into housing privatization projects derives from the National Defense Authorization Act for Fiscal Year 1996, Pub. Law No. 104-106, Title XXVIII, Subtitle A. Military Housing Privatization Initiative (codified at 10 U.S.C. § 2871 *et seq.*, "*Alternative Authority for Acquisition and Improvement of Military Housing*" (referred to in this opinion as the "privatization authorities")). These authorities were sought and granted to enable the Military Services to use "privatization" as a means of addressing seemingly intractable problems with military housing. The privatization authorities comprise a "tool kit" of authorities, which may be used individually or in combination with each other to enable the Military Services to use private-sector approaches to address funding and execution issues. The Air Force embraced the

[1] This memo does not address whether it is permissible to improve similarly situated properties, e.g. junior enlisted housing, at different locations by bundling privatization projects from different bases and using the combined funds to fund the project.

privatization authorities as a quality of life and retention program to address the housing needs of our members -- many with few housing options.

An objective of the Air Force housing privatization program has been the development and maintenance of a program of *private* housing projects using the privatization authorities.[2] Congress did not dictate the manner in which these new privatization authorities were to be used. The Air Force structured its program based on the cost/benefits of using the various privatization authorities and the budgetary constraints imposed on using them.

Air Force Project Structure:

With certain notable exceptions (e.g., Dyess AFB and Patrick AFB), Air Force privatization projects have been structured as "lease-debt" transactions with the following principal characteristics:

- A 50-year no-cost ground lease to the project developer of the real property underlying the development area;
- Transfer of ownership of the existing housing and related improvements to the developer;
- Contractual provisions intended to ensure a regular, but not guaranteed, income stream from member/occupant rents (based on the service-members' Basic Allowance for Housing (BAH)) paid by allotment to the developer;
- When unavoidable, the use of government direct loans or loan guarantees to subsidize the project; and
- The creation of a contractual commitment by the developer to complete the acquisition or construction, maintenance and management of military housing over the duration of the project as described in the accepted offer.

In general, the rental income from privatized housing supports a loan to cover capital improvements and other startup costs and is used to make interest payments, pay the amount borrowed, and provide for future capital, maintenance, and operating expenses for the duration of the project. In some projects the Air Force uses privatization authorities to obtain more "project scope" (better and larger housing) by subsidizing project financing and increasing the amount that can be borrowed by the developer and spent on the project. However, the Air Force goal continues to be the creation of self-supporting projects and to minimize the need for subsidies.

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[2] See "Charter Air Force Housing Privatization Executive Steering Group (ESG)," December 2001.

Limitations On Housing Privatization Projects:

The Continued Viability of MILCON (and Operations & Maintenance) Programs:

The text of the privatization authorities (10 U.S.C. §§ 2871 *et seq.*) and relevant legislative history[3] indicates that these alternative authorities were not intended to supplant the traditional approach used when the Military Services acquire or construct housing, e.g., MILCON, for which funds continue to be authorized and appropriated.[4] The "general authority" section expressly acknowledges the continued viability of the "other authority provided under this chapter [Ch. 169 - Construction & Housing] for the acquisition or construction of [military housing]," and the new alternatives.[5] The language reflects Congressional intent that the traditional and new privatization authorities be treated as independent with separate applications. Specifically, the traditional authorities were to be used for "the acquisition or construction [by the Military Services] of military family housing or military unaccompanied housing" and the privatization authorities for "the acquisition or construction **by eligible entities**[6] of [military housing]."[7] In other words, the traditional authorities contemplate housing built with money appropriated for that purpose owned and operated by the Military Service and the privatization authorities result in housing constructed through lease-debt or other arrangements that is "privatized, that is, owned and operated by an "eligible entity."

Limitation of Privatization Resources to Activities Under the Privatization "Subchapter":

In providing the housing privatization "tool kit", Congress expressly limited the use of these new alternative authorities to activities under the "subchapter" ("*Alternative Authority for Acquisition and Improvement of Military Housing*") rather to activities undertaken using the traditional authorities in Chapter 169 ("*Construction & Family Housing*). The use of the terms such as "military family housing" and "military unaccompanied housing" (together referred to in this memorandum as "military housing") must be read in that context. If revenues could be used

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[3] Statement by Robert E. Bayer, Deputy Assistant Secretary of Defense (Installations) before the Subcommittee on Military Installations and Facilities of the House National Security Committee, March 7, 1996; Report to Congress on the Second Year of the Housing Revitalization Initiative, March 1998, pgs. 8 - 9; The Military Construction Appropriations Act, 2002 and 2003, Public Laws 107-64 and 107-249, respectively; Statement by Chairman Joel Hefley, Subcommittee on Military Installations and Facilities, 2000; and Senate Report 107-68, September 25, 2001

[4] As Mr. Robert E. Bayer, Deputy Assistant Secretary of Defense (Installations) stated before the Subcommittee on Military Installations and Facilities of the House National Security Committee on March 7, 1996, prior the enactment of the privatization authorities: "As military construction projects are converted to projects financed using the new authorities, we expect to use the MILCON savings to fund additional projects." Statement by Robert E. Bayer, Deputy Assistant Secretary of Defense (Installations) before the Subcommittee on Military Installations and Facilities of the House National Security Committee, March 7, 1996.

[5] 10 U.S.C. § 2872 provides:
In addition to any other authority provided under this chapter [e.g., traditional MILCON] for the acquisition or construction of military family housing or military unaccompanied housing, the Secretary concerned may exercise any authority or any combination of authorities provided under this subchapter [i.e., the alternative privatization authorities] in order to provide for the acquisition or construction by eligible entities of the following: (1) Family housing units on or near military installations within the United States and its territories and possessions. (2) Military unaccompanied housing units on or near such military installations.

[6] The section originally used the term "private parties" but this was subsequently changed to "eligible entities," which was defined to include "any private person, corporation, firm, partnership, company, State or local government, or housing authority of a State or local government. See 10 U.S.C. § 2871(5).

[7] 10 U.S.C. § 2872.

for any "military housing" regardless of the authority used to acquire or construct it or ownership, it would render meaningless the language limiting the use of the privatization authorities to the acquisition or construction of military housing by **eligible entities** under subchapter IV of Chapter 169 of Title 10.

Limitations on the Use of the Family Housing Improvement Fund (FHIF):

In establishing alternative authorities for military housing, Congress also created a separate account entitled the "Department of Defense Family Housing Improvement Fund" [8] (referred to as the "FHIF") to "carry out activities under this subchapter with respect to military family housing."[9] Moneys in the Fund come from:

- Amounts authorized for and appropriated to the Fund by Congress;
- Amounts available for the acquisition or construction of military family housing [MILCON] which are transferred to the Fund, if permitted in an appropriations act; and
- Proceeds from the conveyance or lease of property under section 2878, and income from any other activities under the privatization authorities.

These provisions reinforce the concept of total congressional visibility into privatized projects and their separateness from traditional MILCON funded military housing. The privatization authorities specifically restrict the use of resources in the Fund and direct that amounts in the Fund be administered separately and "be used only to carry out activities under this subchapter with respect to [military housing acquired or constructed by eligible entities]."[10] Further, the statute requires that all "[p]roceeds from the conveyance or lease of property or facilities under section 2878"[11] and "income derived from any activities under this subchapter"[12] be deposited into the Fund and be used for "activities under this subchapter with respect to [military housing acquired or constructed by eligible entities]."[13] There is no explicit authority for extracting "consideration-in-kind" e.g., improvements to non-privatized housing, from the project.[14]

Statutory Construction and Incongruous Results:

As a matter of statutory construction, statutes must be construed in a harmonious matter if at all possible. We found from this review that an interpretation that would allow the use of privatization funds on non-privatized properties would result in incongruous and clearly unintended results. For example:

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[8] 10 U.S.C. § 2883.
[9] 10 U.S.C. § 2883(b)(2).
[10] 10 U.S.C. § 2883(b).
[11] 10 U.S.C. § 2883(c)(1) and (2).
[12] 10 U.S.C. § 2883(c)(1) and (2).
[13] 10 U.S.C. § 2883(d)(1) and (2).
[14] The existing leasing authority in 10 U.S.C. § 2667 authorizes leases for cash or in-kind consideration and provides broad discretion in how and where such consideration is used. It also requires that we obtain fair market value, report to the Congressional defense committees if the value exceeds $500K, make annual reports to Congress, and specifically subjects the lease to local taxation.

Section 2883. Department of Defense Housing Fund. A broad interpretation would permit the use of FHIF resources to pay MILCON and O&M obligations in addition to privatization projects. This would defeat the purpose of providing for a separately administered fund. There would be no need for a segregated fund if the privatization resources were intended to be a fungible pool of cash available for both privatized and non-privatized projects. Using project funds for housing that creates only liabilities and contributes no revenues to the privatization project would be inconsistent with the purpose of a separate privatization Fund.

Section 2880. Unit size and type. This section exempts housing acquired or constructed "under this subchapter" from the limitations on size and type based on a member's grade. An unconstrained interpretation of the term "military housing" would circumvent the controls in 10 U.S.C. § 2826 (officers) and § 2856 (enlisted) on the size and type of quarters acquired or constructed using the traditional authorities. The exemption from size and type limitations were intended to provide an incentive for privatization as well as enable developers to provide a product that would be marketable to the general public in the absence of an adequate military tenant base, not as a means of avoiding size limitations in non-privatized housing.

Section 2881. Ancillary supporting facilities. This section authorizes the acquisition or construction of "facilities related to military housing units, including facilities to provide or support elementary or secondary educations, child care centers, day care centers, tot lots, community centers, housing offices, and unit offices and other similarly facilities for the support of military housing."[15] An unconstrained interpretation of the term "military housing" would permit the use of privatization funds for construction of such facilities anywhere military housing was located, not just for those supporting privatized communities.

Section 2876. Rental guarantees. This section authorizes the Air Force to enter into agreements with developers to guarantee occupancy and rental income in privatized housing. This authority would have little meaning where the Air Force continued to own the property after it was renovated or constructed using project funds. Under those circumstances, the Air Force would have the exclusive right to control occupancy and, since the Air Force would own all interests in the property, it would not pay rent.

Section 2877. Differential lease payments. This section authorizes the Air Force to supplement the rent paid by military members to a lessor of privatized housing to encourage the lessor to make such housing available to military members. This authority would have no applicability if the housing were government-owned. The Air Force would have the exclusive right to control occupancy and, as members assigned to government-owned housing are not entitled to BAH,[16] there would be no "rent" to subsidize.

Section 2878. Conveyance or lease of existing property and facilities. This section authorizes the lease or conveyance of property and the use of the proceeds from such lease or conveyance for activities under the "subchapter." However, this provision also mandates that any such lease or conveyance:

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[15] 10 U.S.C. 2871(1).

[16] Members who are assigned to government-owned or leased housing are not entitled to a housing allowance. 10 U.S.C. § 2882(b).

> [E]nsure that a suitable preference will be afforded members of the armed forces and their dependents in the lease or sublease of a reasonable number of the housing units covered by the conveyance or lease, as the case may be, or in the lease of other suitable housing units made available by the purchase or lessee.

If Congress had envisioned that the consideration for such leases would be used for non-privatized military housing, which the Air Force would continue to own and control, there would be no need for the requirement to negotiate a military preference. A preference is needed only where the Air Force has given up the right to control the occupancy of the privatized housing by leasing or conveying the property.

Finally, certain of the privatization authorities, such as differential lease payments,[17] income or occupancy guarantees,[18] leases [of housing constructed by the private sector pursuant to the MHPI authorities],[19] and assignment of members to housing[20] would enable the Air Force to retain a degree of control over the use of privatized housing similar to the control exercised over non-privatized housing. However, due to the budget scoring requirements[21] applied to such transactions, the practical effect is that the use of the privatization authorities in this manner would cost as much or more than the cost of acquiring or constructing the housing using traditional MILCON. Because of this, the Air Force, as a matter of policy, elected not to use these authorities. If the privatization authorities were to be interpreted to allow the use of project funds for non-privatized housing, the Air Force (and all of DOD for that matter) could use these authorities to avoid these scoring implications while retaining all rights associated with fee ownership.

Despite the use of the generic term "military housing," throughout the privatization authorities, the term "military housing" must be interpreted within the parameters of the alternative authorities if the other authorities for military construction are to be given any meaning. Accordingly, money generated in privatization transactions should not be used to build, improve or benefit non-privatized properties.

Congressional Interest in General Officer Quarters (GOQs) and Historic Properties:

In addition to the statutory limitations on the use of privatization funds as discussed above, Congress has consistently expressed a strong interest in how the military departments manage their GOQs and historic properties.[22] For many years, Congress has imposed limitations

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[17] 10 U.S.C. § 2877
[18] 10 U.S.C. § 2876
[19] 10 U.S.C. § 2874.
[20] 10 U.S.C. § 2882.
[21] Income or occupancy guarantees and leases [of housing constructed by the private sector pursuant to the MHPI authorities] provide, or seek to guarantee, an income stream to a housing provider and the entire net present value of the lease or commitment must be scored upfront as an obligation at the time the contract is finalized. The assignment of service members to housing, when combined with a loan guarantee for base closure, deployment and downsizing, would effectively eliminate default risk, and therefore, would require the full face value of the loan to be counted as government participation. See Report to Congress on the Second Year of the Housing Revitalization Initiative, March 1998, pgs. 8 - 9.
[22] *See* Senate Report 107-68, September 25, 2001 ("The Committee is concerned about the escalating costs of improving and maintaining general and flag officer quarters. The Committee recognizes that many of these quarters

on the source of funds and amounts expended on GOQs and historic properties and required full disclosure to Congress because of their concerns with escalating costs.[23] A recurring general provision in the Military Construction Appropriations Act limits the amount of funds ($35,000) that may be expended to maintain GOQs without reporting to Congress and requires that those funds come from Military Family Housing, Operations and Maintenance (MILCON) appropriations.[24] We are aware that more than one Antideficiency Act case has been reported to Congress and OMB as a result of these limitations being exceeded.[25] The most recent congressional inquiry into renovations of GOQs was related to questionable expenditures of MILCON funds for improvements at Air Force Academy GOQs. The Military Construction Appropriations Act of 2002 and 2003 (Public Laws 107-64 and 107-249, respectively) also require the Under Secretary of Defense (Comptroller) to report annually to the Committees on Appropriations all operations and maintenance expenditures for each individual general or flag officer quarters for the prior fiscal year.

Congress has consistently expressed its interest in understanding and having complete visibility into expenditures for GOQs and historic properties. Such interest has typically taken the form of close scrutiny of MILCON budget submissions and annual reminders of the spending limitations and reporting requirements. The consistent theme in this regard has been the need for total transparency, and the invitation to "pursue innovative funding sources and operational methods" through privatization must be construed in that context. The military departments have been criticized when they have attempted to do otherwise, for example, categorizing parts of the superintendents' residences at both the Air Force and Naval Academies as other than GOQs quarters to avoid the annual reporting and funding limitations imposed by applicable statutes. Incidents such as this have heightened Congressional scrutiny of expenditures on GOQs and historic housing, and any attempt to circumvent oversight of these projects though housing privatization transactions could negatively impact the Air Force's continued ability to modernize

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are historic and as such, require maintenance, preservation, rehabilitation, and restoration beyond the normal Department of Defense standards. These preservation activities contribute significantly to the annual cost of maintaining these quarters. The Committee urges the Department to look for innovative ways to reduce these expenses while ensuring that projects are consistent with DOD standards and not excessive. While the Department of Defense should preserve these quarters as a historical legacy, the military services should also explore more cost effective ways of rehabilitating and restoring historic family housing, such as the use of synthetic building materials where appropriate. The Committee has again included section 125, which requires that the Military Construction Appropriations bill be the sole source of all operation and maintenance for all flag and general officer quarters. Based on the escalating costs of routine repair and maintenance activities, the Committee recommends that the annual limitation of expenditures for repairs on these quarters be raised from $25,000 to $35,000 per year.")

[23] *See, e.g.,* House Report 107-207, September 20, 2001 ("As noted in the past, the Committee is concerned with the inordinate expenditures associated with improving and maintaining historically significant properties. The National Historic Preservation Act of 1966 requires the Department to manage those units listed on the National Historic Register, as well as any units that meet the criteria of being potentially eligible for listing, in a way that preserves their historic significance and integrity. In the future, these costs will grow as the number of properties eligible for listing on the Register grows. In the next five years alone, the Department will have approximately 38,000 structures that reach 50 years of age. To reduce the costs associated with maintaining historic properties, the Department should pursue innovative funding sources and operating methods. Several examples were discussed during the Historic Properties hearing on March 15, 2001, such as expanded gift acceptance authority, leasing to third parties like the Park Service, and demolition where appropriate.")

[24] See The Military Construction Appropriations Act for the Fiscal Year Ending September 30, 2003, Pub. L. No. 107-249, § 125, October 23, 2002.

[25] Antideficiency Act Violation Case No. F00-04, Bolling AFB General Officer Quarters, April 30, 2003.

military housing and result in additional Congressional intervention and oversight into the process.[26] While GOQs and historic housing could be included in a privatization project, in light of the strong congressional interest in GOQs and historic housing, the use of privatization resources to fund renovations of this housing when not part of the privatizations is inconsistent with congressional intent and expectations.

Other Considerations:

Both DOD and the Air Force represent housing privatization as a quality of life and retention program meant primarily to address the housing needs of our members with the fewest housing options. While every project includes some imbalances that require one member to subsidize the true cost to another, these are relatively minor and would be extremely difficult to avoid. In the projects at Hickam and Offutt AFBs, it is clear that member rents are not being used just to subsidize another member's rent, but to pay an Air Force obligation. When the beneficiaries of this subsidy are senior officers, it becomes even less palatable or defensible given Air Force representations regarding the goals of privatization.

Allowing the use of privatization funds to build, improve, or benefit non-privatized properties, creates the potential that individual bases will attempt to use project funds to pay for future MILCON and O&M obligations and undermine the financial viability of the privatization projects. Air Force projects are structured to include various reserve accounts intended to ensure that the property is adequately managed and to provide for whole house construction at the 25-year point. Monies in these accounts may be seen as solutions to near-term funding problems unless access is clearly constrained to activities that directly and primarily benefit privatized housing.

Allowing privatized funds to be used to build, improve, or benefit non-privatized properties ensures a future maintenance obligation without a guaranteed means to pay it. Unless the privatization reserve accounts are used for such obligations, they can only be addressed through appropriations, with the likely perpetuation of the circumstances that led to the need for the privatization authorities -- inadequate funding.

Finally, we believe using project funds for non-privatized properties prevents the Air Force from most effectively using the privatization authorities to solve the Air Force-wide housing problem. Specifically, these transactions can be structured to generate funds in excess of that needed to meet an individual base's housing requirements and to enable the Air Force to use such funds at installations where the rents will not support acquisition or construction of housing of the quality desired. The privatization authorities allow the Air Force to lease property to the developer and charge rent. At present we do not charge rent, effectively eliminating land costs as a component of project financing. Ground rent could be charged to recover excess project revenues, paid into the Family Housing Improvement Fund, and used to subsidize acquisition or construction at other Air Force bases. While this would require a more controlled

[26] This opinion does not address potential Congressional scrutiny if GOQs and historic housing are included as part of a housing privatization transaction and renovated from project funds, however these concerns should be addressed before such housing in included in a proposed project.

and standardized approach in our design of housing projects, it should enable more housing of equal or similar quality to be privatized.

Summary of Conclusions:

Based on a review of the privatization authorities and a reasonable interpretation of the statutory language, as well as consideration of other relevant factors including congressional interest in funding for renovations of GOQs and historic properties, I do not believe that the privatization authorities permit the use of privatization funds to build, improve or benefit non-privatized properties.

Privatization authorities should be used to address the housing needs of our members living in privatized housing. The viability of these projects should not be burdened with miscellaneous MILCON or O&M expenses, but enabled to succeed on the strength of their internal financing. In order to preserve privatization as a tool to address this significant quality of life issue, privatization should not be used in any way that would cause Congress to question our ability to use these authorities as intended.

MARY L. WALKER
The General Counsel