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STATEMENT OF

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BEFORE THE SUBCOMMITTEE ON
MILITARY INSTALLATIONS AND FACILITIES
OF THE HOUSE ARMED SERVICES COMMITTEE

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Introduction

Mr. Chairman and distinguished members of this Subcommittee, thank you for the opportunity to share the status with you of the Department of Defense's Military Housing Privatization Initiative, utilities privatization efforts and the asset management program. I look forward our continuing work with you to ensure that our military installations and facilities can best support readiness and quality of life.

Sustaining the Foundation

To ensure that America's defense posture remains strong and the quality of life for our military members and families is excellent, the Department's military installations and facilities must be functionally and technologically sound. These installations and facilities are the foundation from which our forces successfully execute their diverse strategies and missions. The Department of Defense (DoD) must constantly be in an advance motion to sustain the foundation of the its military forces and adapt to changing requirements. With this in mind, I will address three important initiatives as requested by this Subcommittee – the Military Housing Privatization Initiative, Utilities Privatization and Real Property (Asset) Management.

Improving Quality of life: Military Housing Privatization Initiative

The quality of housing for military members and their families continues to be a critical element in attracting and retaining high caliber personnel who make our military forces the best in the world. But the military housing we provide is old, below contemporary standards, and in need of extensive repair. Realizing the importance of safe, adequate housing, Secretary Cohen made improving housing one of his top priorities for this year. In recent testimony before Congress, the

Secretary stated that it is his top priority to improve the support of our men and women in uniform, their families and our civilian workforce. To that end, he has established and funded a major 3-pronged initiative to improve military housing, which includes the following components:

-increasing housing allowances to eliminate the out-of-pocket costs paid by Service members for private sector housing

-increasing reliance on the private sector through privatization, and

-maintaining military construction funding.

As I have testified before this Subcommittee on March 2nd, the Secretary's initiative increases the DoD's program for housing allowances by over $3 billion over the next five years. This funding increase, coupled with legislative relief from the requirement for at least 15% out-of-pocket expense, will enable us to gradually increase housing allowances (subject to Congressional authority and appropriation), providing the Service member with more money to pay for housing. Consequently, average out-of-pocket costs will be lowered from 18.8 percent this year to 15 percent next year, and will be eliminated completely by 2005. The initiative continues major improvements in compensation for Service members. It also further strengthens ongoing efforts to eliminate DoD's inadequate on-base family housing by 2010 and barracks for single members by 2008. It also complements our military construction (MILCON) efforts in the housing area. This budget request, while slightly short of the amount appropriated by Congress last year, is significantly (almost 18%) higher than DoD's request last year.

The Secretary's initiative will benefit all Service members and improve their quality of life in three significant ways:

1. Higher allowances will help members who live off base to afford good quality housing. Both the quality and availability of their off-base housing options will immediately increase. By

2005, the typical member living off-base will have no out-of-pocket housing expenses – the same as their counterparts living in government quarters on base.

2. Higher allowances will increase and enhance housing privatization, further improving Service member access to quality housing. Higher allowances will increase the income available to private sector developers, facilitating increases in the quantity and quality of privatized housing.

3. The combination of increased allowances and continued use of privatization will permit more efficient use of current military construction funding. 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 (O&M) funding more wisely. Quantifying the decrease in on-base housing is a complex and difficult analysis, since impacts at each installation will vary. A single algorithm will not apply due to varying market considerations.

Need for Housing Privatization

Two-thirds of DoD's housing inventory in the Continental United States (CONUS) are considered inadequate, totaling over 180,000 units. For the Department to fix this problem, using only traditional military construction would take up to 30 years and cost approximately $16 billion. Recognizing this, 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 help us eliminate a serious shortage of quality affordable housing. Using these privatization authorities, we can provide higher quality housing both on and off base, as well as stretch and leverage the Department's limited housing dollars by a factor of at least 3:1. The two most recent projects awarded, at Lackland Air Force Base, Texas, and Fort Carson, Colorado, leverage military construction dollars at rates of 8:1 and higher. Given the shortage of military construction funds, the use of housing privatization is essential for the Department to achieve our goal to eliminate inadequate military family housing by 2010.

Housing Privatization Progress

In the first four years of the initiative, the Department has made significant progress in determining how to financially and logistically make this program work. This progress can be divided into two distinct phases. During the first phase, from 1996 to 1998, projects were developed under the aegis of a joint Housing Revitalization Support Office (HRSO). This joint office, composed of representatives of the office of the Secretary of Defense as well as detailees provided by the Military Departments, oversaw all aspects of the housing privatization process from initial site visits to final solicitation. Under this organization, significant strides were made in developing program criteria, financial models, legal documents and instruments, and budget scoring guidelines. However, only two on-base projects testing the new authorities reached the solicitation stage during this phase, largely due to the unwieldy centralized management exercised under this original arrangement. Since the complexities involved in using these new financial tools could only be fully explored by requesting private sector proposals and working through the solicitation process, management changes were necessary to accelerate project execution.

In October 1998, the Department devolved execution of housing privatization projects to the Military Departments while maintaining basic oversight responsibility in the Office of the Secretary of Defense. As the Deputy Under Secretary for Installations, my office is tasked to provide that oversight for the Secretary. The Military Departments provide housing privatization lists with associated timelines that are closely monitored by my office. Additionally, all projects are reviewed to ensure the validity of the housing requirement, the availability of funding, financial viability of the concept and existence of sufficient competition in the solicitation process. This second phase of the program significantly increased the number of projects in solicitation. Since the Military Departments had to decide which sites to privatize, this step also freed up military construction projects at non-privatization sites, which had been held pending privatization decisions. We are just starting to realize the full benefit of lessons learned as the twelve projects currently in solicitation reach completion.

We now have four projects that have been awarded and/or completed and, as mentioned, another twelve which are currently in solicitation. The lessons from the awarded projects are significant and the projects in solicitation are steadily increasing our knowledge as they proceed to award. A summary of the projects follows:

Projects Awarded

- **Corpus Christi I** -- In May 1997, military families in Texas from Naval Station Ingleside, Naval Station Corpus Christi and Naval Air Station Kingsville commenced occupancy of two townhouse complexes. This project provided 404 units of off base housing for a total development cost of $30M. The Navy’s equity contribution was $9.5M, with the private developer financing the rest. (Spending the same amount of money using traditional military construction would have yielded one-fourth the number of units.) These complexes offer quality rental housing with such amenities as swimming pools, soccer and baseball fields, and basketball courts. At the end of this ten year limited partnership, the Navy will receive one-third of the net value and will be repaid its equity share.

- **NAVSTA Everett I** -- A second Navy limited partnership was completed in the summer of 1997 and is occupied by military families from Naval Station Everett, WA. The Navy invested

$5.9M to facilitate the construction of 185 new units of off base family housing. The developer provided the remainder of the total project cost of $19M. As is the case with the Corpus Christi project, sailors are given first preference to rent and the Navy will share in the proceeds and equity at the end of the ten-year partnership. An added feature of this project is that military occupants have the option to purchase their units, at below market prices, starting in the last five years of the partnership. This project achieved a 4:1 leverage compared to military construction.

- **Lackland AFB** -- In August 1998 the Air Force awarded a project to construct 420 new family housing units at Lackland AFB, TX. The Air Force provided a long term lease of government land for a nominal rent, a direct loan for $10.6 million, and a guarantee of a private sector loan against base closure, downsizing, and deployment. The developer provided the remainder of the financing for this $42.6 million project. The scored cost to the Air Force for providing the loan and guarantee was $6.3 million. The developer will own, maintain and operate the development and will rent the housing units directly to service members. This project, which is under construction, achieved a leverage of 8:1, when compared to the cost of an equivalent military construction project.

- **Fort Carson** -- In September 1999, the Army awarded a project to renovate 1823 existing family housing units and construct 840 new units at Fort Carson, Co. The developer will own, maintain and operate the entire development and will rent the housing units directly to the service members. The Army provided a long-term lease of government land for a nominal rent, title to the existing housing units in need of renovation, and a guarantee of a private sector loan against closure, downsizing, and deployment. The developer provides the financing for this $229M project. The scored cost to the Army for providing the loan guarantee was $10.3M. This project achieved a leverage of 23:1.

Projects in Solicitation

These twelve projects are in various stages of solicitation and explore various different uses of the Military Housing Privatization Initiative authorities. Some of their unique features are described:

- **Everett II, Kingsville II** -- Repeats and improves successful Navy off base limited partnerships.
- **San Diego, New Orleans, South Texas --** First Navy projects to include existing on base housing and new Limited Liability Corporation structure.
- **MCLB Albany** -- Proposes transfer of excess off base housing in exchange for a lesser number of on base units. No government cash contribution is required.
- **Camp Pendleton --** First Marine Corps use of loan authority.
- **Fort Hood, Ft Lewis --** First use of Army's Request for Qualifications (RFQ) process. Using this process the Army will competitively select a development partner who will then work closely with the Army to craft a Community Management and Development Plan to improve the military family housing at these bases. If the Army and DoD approve the plan, the developer will then implement the plan, following appropriate Congressional notification.
- **Elmendorf AFB --** Tests privatization in unique Alaska environment (severe weather, limited construction season).
- **Robins AFB --** Proposes transfer of units and land on severable part of base. Includes land swap with local community and transfers control of DoD school, as well.

- **Dyess AFB --** First Air Force off-base project. Proposes use of government first mortgage (vice second mortgage in other projects).

Lessons Learned

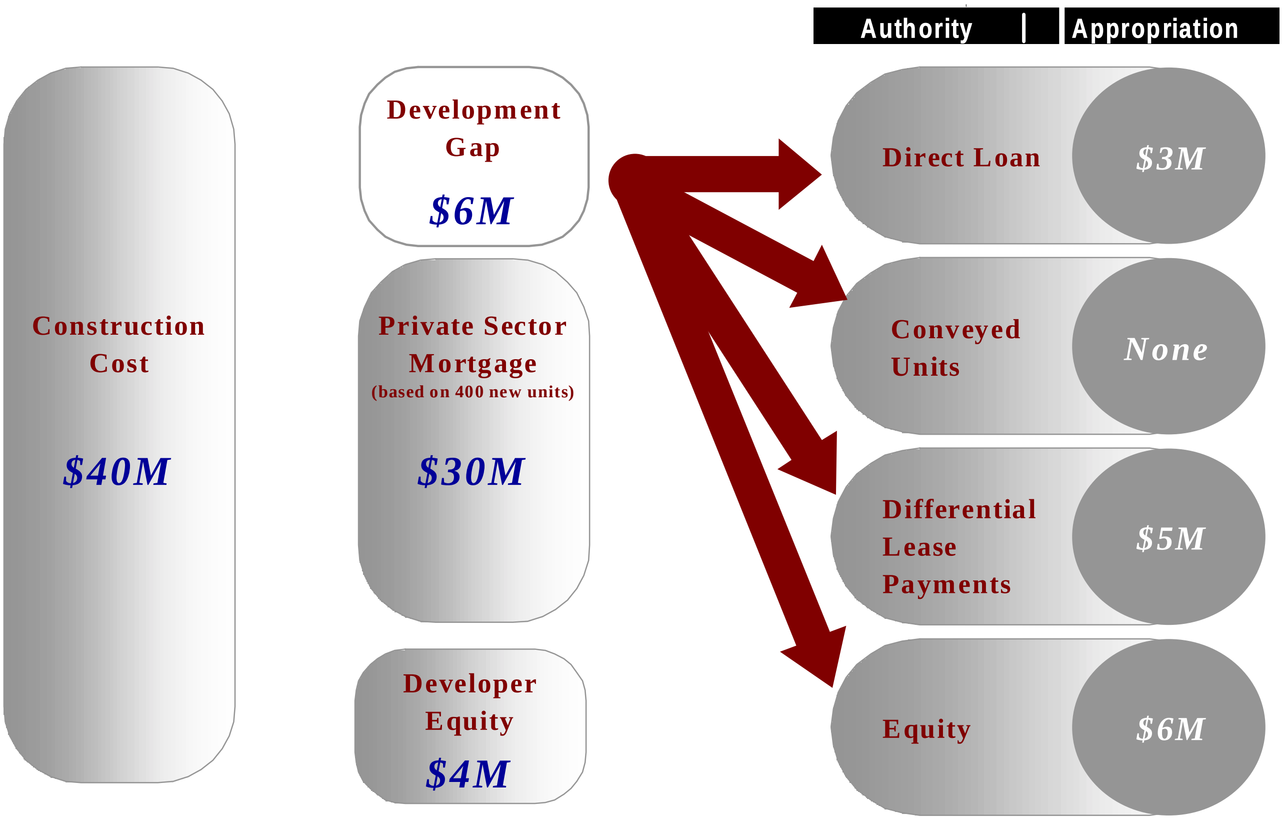
As I mentioned earlier, our initial sixteen projects have considerably increased our understanding of how best to employ the authorities. Although we do not feel our experience to date justifies a request for permanent authority at this time, we believe it is crucial to obtain an extension on our temporary privatization statutory authority to fully realize the benefits these authorities offer. While some of the authorities have proven more useful than others, we also feel strongly that all of the authorities should be extended so that we can more fully develop their optimal usage. I have included a table which lists the twelve basic authorities with descriptions of their pros and cons. Let me discuss them briefly:

Authority	Section	Description	Benefit	Budget Impact	Where Used
Direct Loan	2873	DoD can provide a direct government loan	Brings additional financing at below market interest rates	***Moderate*** - 30% - 70% of loan amount, depending on terms.	Lackland AFB, TX
Investments (Joint Venture)	2875	DoD can provide equity investment	DoD obtains partnership interest	***Moderate to High*** - Cash equity contribution is scored at 100% upfront	Everett, WA Corpus Christi, TX
Conveyance or Lease of Land and Units	2878	DoD may transfer ownership of units and land by fee simple conveyance or long-term lease	Transfer of ownership secures private sector financing Cash flow from units allows for additional private sector debt to fill financing gap	None	Lackland AFB, TX - land lease Ft. Carson, CO - conveyance of units and land lease
Differential Lease Payments (DLP)	2877	DoD can provide an additional rental payment directly to the developer	Brings additional financing by increasing rental income	***Moderate to High*** - Net present value of DLPs over life of contract	Everett, WA Corpus Christi, TX
Loan Guarantees	2873	DoD can guaranty private sector loan	Lowers interest rate Ensures availability of private sector financing	***Low*** - 4% - 7% of loan amount	Ft. Carson, CO Lackland AFB, TX

Authority	Section	Description	Benefit	Budget Impact	Where Used
Unit Size and Type	2888	DoD can build to local standards	Results in more cost-effective development	None	Lackland AFB, TX Ft. Carson, CO Everett, WA Corpus Christi, TX
Ancillary Support Facilities	2881	DoD can allow private sector to construct ancillary support facilities for the development (e.g., play areas, jogging trails)	Enhances quality of life for military tenants.	None	Lackland AFB, TX Ft. Carson, CO Everett, WA Corpus Christi, TX
Payments by Allotment	2882	DoD can require tenants to pay rents through allotments	Improves financing by minimizing uncertainty of late payments and non-payment of rent	None	Lackland AFB, TX Ft. Carson, CO
Assignment of Members	2882	DoD can assign members to privatized housing	Could support occupancy during downsizing or deployment	***High*** - Net present value of BAH	None
Build to Lease	2874	DoD can contract for the private sector to build and maintain units for lease by DoD	Central payment by DoD in stead of tenant – analogous to 801 Program	***High*** - Net present value of lease payments	None – prohibitive budget cost
Rental Guaranty	2876	DoD can guaranty occupancy or rental income	Enhances the availability of private sector financing – analogous to 802 Program	***High*** - Net present value of rental payments	None - prohibitive budget cost
Interim Leases	2879	DoD can lease privatized units for an interim period	Technical tool to enable occupancy prior to conveyance	***Moderate to High*** - Net present value of lease payments during interim period	None

Use of these authorities must be understood in context of how housing privatization projects are structured. When developing housing privatization projects, experience has shown that the total funds available between 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.

Why Government Contribution?



There are three basic causes of this development gap. First, consistent with Secretary Cohen's new housing allowance initiative to eliminate out of pocket costs, housing privatization projects require the private sector developer to fund all development and maintenance costs based on the income provided by the rent paid by service members using their allowances, including utilities. Since these allowances are statutorily limited to 15% below market rents, an initial development gap is created. Secretary Cohen's initiative would eliminate this discrepancy, but not until 2005, assuming a statutory change is approved and funded and appropriations provide the required funding.

Secondly, junior enlisted members assigned to on base housing built with traditional military construction normally occupy single family houses with bedrooms based on number of dependents. The same junior enlisted living in private sector housing off-base may only be able to afford a rental apartment, usually with a lesser number of bedrooms. Privatization projects located on base require that developers build housing units, using market standards, but also equivalent to existing on base housing in type and number of bedrooms. To do otherwise would unfairly penalize service members living in on base privatized housing when compared to those living in government constructed housing on the same base. This discrepancy in the type of housing the members' allowances pay for as compared to what the developer is required to build further increases the development gap.

The third factor that affects the development gap is based on unique risk, which is inherent to financing large housing projects on military bases. Private sector lenders are experienced in assessing the normal economic risks involved in housing development. However the risk to a project based on governmental actions (e.g., base closure, downsizing, or deployment) which might reduce the number of available occupants introduces uncertainty can affect the availability, cost and amount of private sector financing. This either adds to project cost or decreases the amount of available financial resources, further adding to the development gap.

The tools provided under the Housing Privatization law allow us to bridge this development gap. The most financially complex authority is the direct government loan. It is also a very efficient method to close the development gap. This would normally be in the form of a second mortgage unless the gap exceeded the available private sector financing, in which case the government should provide a first mortgage. The primary advantage of direct loans is that the amount of the loan is scored in the budget at a subsidy rate (normally 50-70%) determined by the interest rate and terms of repayment. Much of the early strides in the housing privatization program related to developing the complex documents necessary to use government loans.

A second financial method to fill a development gap is to provide a government equity investment. This method avoids some of the complexity involved in creating loan documents and credit monitoring, but is scored as the total amount of the investment and thus does not offer the same up front budget savings that use of a loan does. However, the government becomes a limited partner in the project and has the ability to create control mechanisms not available through use of the loan authority. The government also has the ability to share in any profits produced by the project. This authority is a central factor in Department of the Navy projects.

Lease or conveyance of property and transfer of existing units are two more authorities which are essential to making the projects work financially. Providing good existing units to a projects can increase the developer's rental income stream (and hence the availability of private financing) without significantly increasing the development cost. Likewise, provision of property or housing stock can provide income to a developer, which offsets any development gap. The project at Marine Corps Logistics Base Albany is a prototype which, if successful, will allow housing to be provided on base in exchange for excess housing off base, with no cash contribution required by the Marine Corps.

The ability to provide Differential Lease Payments (DLP's) is another authority which increases the income stream available to the developer, thus enabling more private sector financing and eliminating potential development gaps, without placing a burden on the military member through higher rents. The Navy has proposed use of DLP's with some of their investment deals. DLP's are scored as a net present value of the contractual commitment and are thus costly in budgetary terms.

Loan guarantees covering base closure, downsizing and deployment are necessary in some markets to reduce risk based on these governmental actions as described earlier. When necessary, these guarantees ensure the availability of private financing and lower borrowing costs so that project income streams are sufficient to service that financing. Let me reiterate that these guarantees do not protect the lender from the standard risk of economic failure – the lender assumes and mitigates that risk through its underwriting policies. Our preference is to let market competition dictate whether such guarantees are necessary.

Other authorities help structure the housing privatization projects in ways that don't directly affect the initial development gap, but which reduce expenses over the life of the project. Our ability to build in conformance with similar local housing units releases these projects from onerous restrictions historically associated with military construction and allows private developers to achieve greater economies of scale, both in labor and material costs. Many private sector developers have cited this provision as a major improvement over privatization efforts of the 1980's. Constructing to local standards results in a more cost-effective development and therefore a higher quality project. Additionally the privatization authorities allow ancillary supporting facilities, such as play areas and jogging trails, to be included in these projects to enhance the quality of life of the residents. The Department is interpreting this authority narrowly to mean facilities directly related to the housing and not widespread commercial development.

Three authorities simply enhance execution of the projects once they are awarded. The first two of these allow us to require rents to be paid by allotment and allow us to assign members to the units. Use of these authorities provides stability to the rental income stream and enhances private sector financing as well. We also have an interim lease authority that allows service members to occupy units incrementally in advance of conveyance as opposed to waiting for completion of all units in a project.

Lastly, we have two authorities which we have not yet used due to prohibitive budget scoring: build to lease and occupancy / rental income guarantee. These authorities allow us to either lease units directly from a contractor or guarantee occupancy. These authorities are similar to the Section 801 and 802 authorities of the 1980's, and require the entire life cycle value of the contract to be budgeted up front. While we are currently not employing these authorities, we believe they could be used in limited applications and support extending these authorities along with all the others.

As a close to the discussion of providing funding to bridge any development gap, I would point out that use of government funds in this manner is cost effective because numerous studies have found that providing allowances to service members is less costly over the long term than building and maintaining government housing. Life cycle analyses have been conducted for all projects (except the undefined Fort Hood and Fort Lewis projects) and show privatization to be less costly than military construction in all cases. A recent draft General Accounting Office (GAO) study, Military Housing: Continued Concerns in Implementing the Privatization Initiative, dated February 11, 2000 (GAO Code 702008/OSD Case 1945) reached the same conclusion based on independent calculation of life cycle costs. These results are consistent with a 1996 GAO study Military Family Housing: Opportunities Exist to Reduce Costs and Mitigate Inequities (GAO/NIAD-96-203), which concluded, based on its own studies as well as those of the Congressional Budget Office, that the cost to the government is significantly less when military families are paid a housing allowance and live in private housing.

Project Characteristics

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

This procedure, combined with other financial and contract documents, is designed to ensure the long-term viability of the project. With the help of private sector experts we are compiling underwriting guidelines to capture lessons from the Army's recent project award at Fort Carson, Colorado. These underwriting guidelines will help define financial mechanisms to make sure operating expenses, management fees, project reserves, loan servicing and reinvestment accounts are properly funded from project revenues to ensure long term viability of the privatization projects.

We have also learned from our first on-base projects at Fort Carson and Lackland AFB that long term ground leases and contract terms enhance the quality of the projects. Private sector financing dictates long term mortgages based partly on the magnitude of the loans that require stretching out the repayment term to allow project revenues to meet debt service requirements. Additionally, by requiring projects to be maintained for 50 years, we have seen innovative solutions proposed by the private sector in our first solicitations that reduce risk of project failure. In fact requiring the private developer to commit to provide quality affordable housing for long terms is responsible stewardship of the up front government contribution to these projects. Lastly, privatization projects involving improvements on government property that revert to government control before the useful life of those improvements are considered government projects under federal budget rules. In these situations, additional budget scoring would be required at the commencement of the project based on the length of the project and useful life of the housing.

While not a bar to shorter-term projects, it would add to up front costs and reduce budget leveraging.

Next Steps

As I stated earlier in my testimony, continued privatization is essential to the Department's plans to renovate, replace or demolish its unsuitable housing by 2010. We are working to complete the projects we currently have in solicitation and to pursue the remaining projects, subject to approval by my office, as stated in our current quarterly report. The Air Force has identified six housing privatization sites for possible privatization in FY01 in accordance with their family housing master plan and FY01 budget submission. We intend to pursue such projects subject to approval of viable concepts and following appropriate Congressional notification. I will also review projects presented by the other Military Departments that meet the same criteria and compare them with their family housing master plans due in June of this year. I will also ensure that the lessons from our initial projects are captured and disseminated to improve any new projects. The recent GAO draft study, Military Housing: Continued Concerns in Implementing the Privatization Initiative, mentioned earlier, made a number of recommendations with respect to program oversight with which I concur. Let me detail what I have in mind.

Privatization Evaluation Plan

I have initiated a plan to establish "Peer Review" and "Audit" mechanisms using private sector experts to evaluate privatization projects across the Services and capture the "Best Bets" or best business practices, as well as illustrate less successful strategies. DoD has employed these consultants since 1996 in the evaluation of the housing privatization program and they have produced a wealth of monitoring and project evaluation materials used in many of the initial projects. They have also participated in evaluation of specific financial proposals and produced white papers on the complexities incurred in monitoring loans and loan guarantees. These efforts culminated in a Post Award and Monitoring Workshop in April 1999 that gathered and disseminated lessons learned from all Service participants. The "Peer Review" process will be used to develop a formal Evaluation Plan. This plan will be reviewed and approved by the Installations Policy Board, which includes participation by the Service Deputy Assistant Secretaries responsible for housing privatization.

We have actively encouraged different privatization approaches by the Services, particularly during the pilot phase of this program. However, I am working on standardizing methods for determining housing requirements, conducting related market surveys, and comparing the cost/benefits of housing privatization projects to traditional MILCON approaches. Consistency must be achieved in evaluation so that effective comparisons may be made. I expect to have a Draft Evaluation Plan in coordination among the Services by later this summer.

Life Cycle Cost Analyses

We are currently responding to the recommendation of the GAO to refine our guidance for life cycle cost analysis. We have used a uniform methodology to evaluate all projects presented to DoD for concept approval since January, 1999. However as we have reviewed more projects, we have identified differences not only in methodology, but also in how specific costs are derived. We have also expanded the costs considered in the life cycle analysis to include consultant support through deal closing and post-award as well as other costs such as construction inspection. Now we intend to issue refined guidance, incorporating GAO's recommendations, which will require the Services to examine the privatization and MILCON alternatives and their associated costs in a uniform and comprehensive manner. We expect to have new draft guidance completed for coordination with the Services in late spring 2000.

The GAO's current report confirms our findings that the life cycle analyses for the initial projects indicate long- term savings when compared to comparable costs of military housing construction. GAO estimates those savings average 11%. We consider those savings to be an important benefit of the program. However, of equal importance is the need to fix the inadequate housing inventory of over 180,000 units within a reasonable period of time. These economic analyses assume the availability of funding for MILCON projects adequate to construct comparable housing projects. An important, albeit unfortunate, underlying reality is that such funding has not been available and that a paramount benefit of privatization is the early delivery of adequate housing and its improvement to the quality of life of our members.

The GAO report inaccurately concludes that if the Secretary of Defense's housing allowance initiative is fully implemented, privatization savings will be less than currently estimated and life cycle costs will likely increase. Under any of the scenarios for deals, which are not yet awarded, there will be mechanisms, such as reinvestment accounts, revenue sharing accounts, or increased rent for leases of government property, which would ensure that the life cycle costs are not increased when allowances are increased. In fact, the increase in allowances should reduce the life cycle costs by making projects more financially viable, thereby reducing the need for up front budget contribution by the government. In addition, greater housing allowances should provide more and better housing units as future projects are developed.

DOD Integrated Housing Strategy

The Department agrees with GAO's recommendation that greater consistency is necessary in validating housing requirements for housing privatization projects. While DoD closely reviews requirements prior to concept approval, justification has been accepted by a number of methods ranging from Housing Market Analyses to independent audit reports. The Services have taken different and inconsistent approaches in determining their housing requirements. Part of the issue involves Service beliefs about other important military values being preserved through on-base housing, regardless of whether the private sector is better able to meet the housing needs off base. Some Services also believe that Service members prefer to live on base, to an even greater extent than a recent Rand analysis indicated. Additionally, the use of seniority in the assignment of housing tends to exacerbate housing shortages by reserving on-base housing for more senior Service members, despite the fact that off-base opportunities may be more limited for junior enlisted due to lower housing allowances.

Increased housing allowances under Secretary Cohen's initiative should reduce on-base housing requirements. Some on-base housing will always be required, however. The Department has begun integration of the MILCON and privatization programs with the housing allowance and housing requirements determination processes. The Department will also need to address current Service housing assignment and construction standards in a coordinated fashion with these previously stated issues. The methodology used to determine these requirements are complex and consensus is not easily reached. We are working hard to achieve consistency in this process, with some of our ongoing studies mentioned in GAO's report. However, private sector standards must also be considered so that the private sector is not forced to build military "unique" houses, incompatible with civilian market standards, thereby increasing labor or material costs or increasing risks should guarantees need to be fulfilled.

Additionally, the Department has several senior working groups to help achieve consistency and coordination in this effort. The Installations Policy Board (IPB), which I chair, is comprised of senior leadership from the Services' secretariats and engineer staffs, as well as key Office of the Secretary of Defense (OSD) organizations. The IPB is a deliberative body through which important issues affecting installations are debated, and Department-wide guidance, policies, and decisions are made. It is instrumental in developing new initiatives and enhancing joint efforts within the Department. Various staff working groups support the IPB. In addition, the Department is establishing a senior-level joint Housing Policy Panel to provide guidance for determining housing requirements and to establish clear policy for meeting these requirements.

How Can Congress Help?

This year we are requesting that Congress amend Section 2885, Title 10, United States Code, to extend the Military Housing Privatization Initiative pilot program for an additional five years. I firmly believe these private sector tools are critical to providing quality housing over the long haul. Continued privatization will provide important leveraging of military construction dollars, further stretching the benefits realized from these scarce resources. This will significantly contribute toward meeting our goal of revitalizing or divesting our inadequate housing by 2010, using both traditional MILCON and privatization authorities.

In addition to requesting an extension of the housing privatization authorities, we are requesting legislation that would amend Section 2872, Title 10, United States Code, by inserting a new subsection permitting a Service to credit any reimbursements received by the Service from the owner of the privatization project for utilities or other services provided by the military bases into the account from which the utilities or services were funded, rather than into the general treasury. This will correct an existing disincentive to privatize at the installation level.

Other than this one change, we are requesting that the authorities be extended in their current form while we continue to pursue the best ways to employ them. As I have described in this testimony, I believe all of the authorities have potential uses and feel strongly that it is too early to preclude the ability to employ them in seeking better housing for our military families.

Energy Management and Utilities Privatization

The Department has undertaken an integrated program to optimize the management of its energy use and utility systems—seeking to increase efficiency and reduce costs while improving reliability and safety. This program has three elements: (1) reducing energy and water consumption; (2) taking advantage of deregulated energy commodity markets; and (3) privatizing the utilities infrastructure.

Conserving energy is important to the Department, because it saves money and also reduces greenhouse gas emissions harmful to the environment. In fiscal year 1999, DoD spent over $2.2 billion to buy energy for its installations, consuming over 250 trillion BTUs. Our energy use per square foot in buildings continues to decrease—down almost 20 percent since 1985. We are well on the way towards meeting the President's year 2010 energy reduction goal of 35 percent and plan to use a balanced program of appropriated funding and private-sector investment to continue our progress.

The fiscal year 2001 budget contains $34 million for the Energy Conservation Investment Program (ECIP) to install energy savings measures in our existing facilities through DoD's direct investment. Historically, ECIP project selection was based primarily on cost savings-to-investment ratio (SIR). However, we discovered that many of these projects also were excellent candidates for private-sector investment. We are therefore changing program focus from saving money to saving energy. The priority for ECIP project funding will shift from projects with the highest SIR to projects with large energy savings that typically could not compete for funding, because they required substantial up-front capital investments with long payback periods. We have designated fiscal year 2001 as a transition year for ECIP, so that we can execute the projects that were designed for the fiscal year 2000 program eliminated by Congress and begin the design of projects that meet the new selection criteria.

In fiscal year 1999, the Department greatly increased the use of Energy Savings Performance Contracts (ESPCs) and utility incentive agreements—saving nearly 1.7 trillion BTUs per year—more than doubling the energy savings obtained the previous year. In excess of $6 billion in ESPC investment capacity is now available to DoD installations as a result of indefinite-delivery contracts developed by the Military Departments and a memorandum of agreement between the Defense Energy Support Center (DESC) and the Department of Energy.

DoD is also constructing energy efficient buildings. The Department is employing the principles of "sustainable design" to ensure its new facilities minimize the use of resources and reduce harmful effects on the environment. These buildings will use innovative technologies to reduce energy and water consumption, decrease waste products and increase the recyclable content of construction materials, while creating livable, and more healthy and productive surroundings for the occupants. DoD was instrumental in developing a "Whole Building Design Guide" available to all design professionals, both in government and the private-sector. This intuitive, internet-based tool serves as a portal to the design criteria and other resources needed to construct cost-effective, sustainable buildings.

In order to lower its energy bills, the Department intends to take maximum advantage of electricity rate restructuring. Where practicable, we will bundle regionally the diverse loads of DoD installations to create greater buying power. We have already achieved some success in this area. Power contracts awarded by DESC in California, Pennsylvania and New Jersey, bundled regionally the loads of installations from all of the Military Services and some other Federal agencies to obtain the best rates possible.

The Department continues its efforts to privatize its utility systems using authority granted by Congress in Section 2688, Title 10, United States Code. By getting out of the business of running utilities systems, turning them over to private or public-sector professionals, we can both save money and better focus attention on our core missions. The scope of the task is daunting, however, especially considering that privatization is not without its institutional obstacles. However, we are confident that we will be able to overcome these obstacles by working with our partners in the other Federal agencies.

Defense Reform Initiative Directive (DRID) #9 directed the privatization of electric, water, wastewater and natural gas systems by January 1, 2000, except where uneconomical or for unique security reasons. DRID #49 changed this goal to September 30, 2003, and established two interim milestones: (1) for all systems, determine whether to pursue privatization by September 30, 2000 (go/no go decisions); and (2) issue all requests for proposal (RFPs) by September 30, 2001.

We are on track to meet the goals of DRID #49. In January 2000, the Services reported they owned more than 1,700 systems (aside from systems privatized prior to or since DRID #49 was issued and systems owned by other entities, such as host nations). Go/no go decisions have been made for almost than 1,000 of these systems, with RFPs already issued for over 250 systems. To date, less than 50 have been formally determined to be uneconomical to privatize or classified as exempt due to security reasons.

When the Department disposes of an on-base utility system, and more than one entity expresses an interest in the conveyance, the Department must dispose of the utility systems "using competitive procedures" notwithstanding state laws and regulations regarding who can own a utility system. Congress has not waived the sovereign immunity of the United States with respect to disposal. Any effort to dispose of the system in a non-competitive manner, when more than one entity expresses an interest in the conveyance, even if undertaken to voluntarily comply with state law, would violate the express terms of Section 2688.

Additionally, the state may not regulate the Federal Government's acquisition of utility services related to the on-base utility system. Federal procurement laws and regulations are supreme in this area. The Department must comply with state laws and regulations only when it is acquiring the electricity commodity.

Finally, while the entity to whom the Department conveyed the on-base utility system is not required to submit to state licensing or similar requirements that undermine the Federal competitive selection of that entity, to the extent the state has regulations regarding the conduct of operation and ownership of utility systems, the entity may have to comply with those requirements if those state requirements do not impose a significant burden on the Federal Government, conflict with a Federal system of regulation, or undermine the Federal policy being implemented. This will require a careful analysis of particular state requirements in relation to the Federal action. To create a venue to discuss this and other issues affecting the program, the Department is planning an industry forum at the Defense Logistics Agency Headquarters, on Fort Belvoir, Virginia, early next month.

Ideally, we would like to have integrated utility system privatization with energy conservation and rate intervention, due to their economic inter-relationship—to optimize our results. But due to the varying state regulatory conditions and different start dates for each Service, we want to go forward aggressively with systems privatization. However, to help achieve optimal results, we are developing policy to improve consistency of the economic feasibility analyses and providing key contract provisions. Additionally, we are planning to conduct between four to five pilots to demonstrate ways to mitigate less than optimal results. These pilots would demonstrate all or some of the following: (1) integration of utility system privatization with energy conservation and rate restructuring, (2) joint cross-servicing and regionalization, and (3) including telecommunications.

The Department believes that its energy management and utilities privatization programs will allow tomorrow's installation commanders to better support the missions of the Services' operational commands. The partnerships we develop with private industry through Energy Savings Performance Contracts, utility incentives and utilities privatization will provide the necessary expertise and investment capital to make continuous, incremental improvements to our utility infrastructure and increase its reliability and efficiency.

Real Property (Asset) Management

The Department continues to seek ways to meet its unfunded military construction and operations and maintenance requirements. One method being considered by the Department is better utilization of its underutilized assets, both land and buildings. The Department wants to realize the unused economic value of its property to reduce facility capital and operating costs, and at the same time, fund facility maintenance and revitalization. Enhanced-use leases or land exchanges with the private sector could generate added value (cash or in-kind consideration) to offset some of the infrastructure funding shortfalls, while improving the condition of facilities and preserving historically significant buildings.

To that end, the Department performed a formal review of ways to enhance the efficiency and readiness of DoD facilities by actively marketing unused and underutilized, non-excess, real property to the private sector. In accordance with Section 2814 of the Fiscal Year 1999 National Defense Authorization Act, the Department assessed efforts to identify non-excess property and surplus capacity for lease, the pros and cons of leasing such property and surplus capacity on military installations. On June 8, 1999, I transmitted to this Subcommittee, a report entitled, "Leasing of Non-Excess Military Property", in response to the Section 2814 request. Included in this report was an evaluation of an Air Force proposal to generate base-level efficiencies at Brooks Air Force Base, Texas, and a Navy proposal for commercial development of Ford Island, Hawaii.

Your Committee was instrumental in the successful passage of these legislative proposals and we thank you for your support.

The authority to lease non-excess property under Section 2667 has permitted the Department to put a modest amount of its non-excess, but otherwise not fully utilized property, to productive use by allowing non-federal entities (state and local governments and private sector firms) to use it. Moreover, the proceeds from those leases are intended to supplement underfunded accounts for maintenance, repair services, and environmental restoration. However, Section 2667 has some limitations, which, if removed, would increase Department benefits. The Department could use its non-excess, but not fully utilized property even more effectively and, thus, could further reduce its installation support costs by providing cash or in-kind consideration to renovate and repair facilities, including historic facilities. This year, we are submitting proposed legislation for four modest adjustments to Section 2667, Title 10, United States Code, our current authority to out-lease property. The proposed changes are: 1) give the Department authority to indemnity lessees of real property against liability if contamination is discovered on leased property that was a result of military activities prior to the lease period; 2) authorize the receipt of in-kind consideration, such as: maintenance, protection, alteration, repair, improvement, or restoration of any property, construction of new facilities, and base operating support services; 3) authorize lease revenues to be applied to facility-related requirements, to include historic properties, without additional appropriation; and 4) authorize the military departments to use cash proceeds from leases for construction or renovation of its infrastructure and facilities, including historic properties, subject to Congressional authorization (10 U.S.C. 2802) of the specific projects.

Currently, DoD has a modest number of real estate leases that generate an annual income of over $22 million in both cash and in-kind services. This represents approximately one third of one percent of the Department’s annual $6 billion facilities capital improvement requirement.

With increased emphasis, the Department could expect to realize, on average, a tenfold increase in cash and in-kind services within five years.

In addition, the opportunities to make better use of historic facilities while preserving them would improve with the enactment of the proposed revision to Section 2667. One of our special challenges is sustaining and preserving the Department's historic facilities. We manage these facilities the same as we do other properties, but they do pose a challenge because of their intrinsic historic and cultural value. Historic facilities may have higher sustainment costs because of age, size (for some housing, in particular) and the unique materials they may require. However, such building materials generally have a longer life than most modern materials, resulting in lower life cycle costs. Close association with State Historic Preservation Offices has helped keep costs down as well, by compromising on a case-by-case basis on the types of materials that can be substituted. Approximately 16,000 DoD properties (e.g. administration buildings, housing, archeological sites) are either listed on the historic register or eligible (has completed registry evaluation and is awaiting formal approval) for listing.

Conclusion

This concludes my prepared testimony. In closing, Mr. Chairman, I sincerely thank you again for giving me this opportunity to describe our efforts for both housing and utilities privatization and asset management. I urge your support in approving the requested extension of our housing privatization authorities and your support for our utility privatization and asset management initiatives. I look forward to working with you to further these essential initiatives.