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Statement of
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(Sustainment)

Before the Senate Committee on Armed Services
Joint Subcommittee on Readiness and Management Support and Personnel

on the

Military Housing Privatization Initiative

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Introduction

I want to thank you, Chairmen Sullivan and Tillis, Ranking Members Kaine and Gillibrand, and distinguished members of the Subcommittees. I'm honored to appear before you this afternoon in my new capacity as Assistant Secretary of Defense for Sustainment to discuss the Military Housing Privatization Initiative and the Department's commitment to supporting the housing needs of Service members. Having lived in on-base family housing nine times during my active duty career, I understand the importance of safe, quality housing to our military families.

In return for the sacrifices they make in service to our nation, Service members and their families expect a safe and secure place to live, good schools for their children, access to good medical care, and a viable relocation process that respects their household goods. You have my pledge that the Department of Defense is committed to fulfilling this sacred contract with Service members and their families, to include ensuring they have access to safe, high quality, and affordable housing where they will want and choose to live. I look forward to working with the Committee to support the priorities of the Department and the quality of life for our military members and family members who are called to sacrifice so much for public service.

Military Housing Privatization Initiative Overview

Under the Military Housing Privatization Initiative (MHPI) legislation established in 1996, the Military Departments have privatized 99 percent (more than 200,000 units) of installation family housing in the U.S., with more than 80 MHPI projects currently in place across approximately 150 installations.

The Department is confident that housing privatization was the right thing to do. Privatization has dramatically improved the quality of on-base housing and has facilitated long-term investment necessary to maintain high quality housing. The MHPI allowed the Military Departments to leverage private sector expertise and funding to improve the quality of installation housing in the United States much faster than DoD could have done through traditional military construction and ongoing operation and maintenance funding. Before privatization, the housing on our U.S. installations had a \$20 billion maintenance backlog, which the Department of Defense (DoD) estimated would take more than 30 years to address using traditional military construction. The lack of sufficient Military Department funding to adequately maintain quality housing severely impacted Service member quality of life, creating recruitment and retention challenges, thereby impacting readiness. These realizations contributed to DoD's conclusion that housing management, not a core DoD mission, needed to be addressed through privatization.

Under the MHPI, Military Departments conveyed their existing government housing units to competitively selected privatization entities (i.e., the MHPI projects). MHPI projects operate under long-term (~50-year) ground leases and associated legal agreements with a Military Department, with one 25-year option period. In return, the MHPI projects assumed responsibility for operation, maintenance, construction, and replacement of the housing during the lease term, in accordance with the MHPI authorities as defined in Title 10, United States Code.

At present, 99 percent of the construction and renovation planned for the 5 to 10-year initial development phase (IDP) of the individual MHPI projects has been completed, to include construction of more than 75,000 new units and major renovations of more than 50,000 units. This represents more than \$32 billion in total development achieved with less than \$4 billion in government funding as authorized under the MHPI authorities.

A crucial part of the housing privatization model is that Service members, except for a small number of key and essential personnel, are not required to live in privatized housing. Service members who choose to live in MHPI housing receive BAH, sign a lease, and use their BAH to pay rent just like Service members who choose to rent housing in the local community. The fact that Service member chose where to live (on or off-base), incentivizes MHPI projects to maintain quality housing to attract and retain tenants.

Although the Military Departments retain certain rights under the project's legal documents MHPI partners are not DoD or Military Department contractors. The main role of the Military Department is to monitor the MHPI projects to ensure adherence to the terms of the project documents, as well as applicable legal and regulatory requirements. Additionally, the Military Departments monitor MHPI projects to ensure project financial performance can sustain quality housing over the life of the ground lease. To this end, the Military Departments monitor housing occupancy and resident satisfaction, as well as revenue, operating expenses, operating budgets, and the overall financial health of each MHPI project, to include the project's sustainment and recapitalization funding as compared to pro forma expectations and project needs. Depending on the particular structure of a given project, the Military Departments may also have approval authority for project budgets, certain major project expenditures, changes in property management companies, or other key project oversight decisions.

The Office of the Secretary of Defense Oversight Role

The Office of the Secretary of Defense (OSD) provides portfolio management of the MHPI program, meaning policy oversight, long-term program monitoring, and ensuring that the projects comply with the requirements of Office of Management Budget (OMB) Circulars A-11, A-129, and budget guidance. My office issues MHPI policy and program guidance, including guidance on MHPI project requirements for OSD and OMB review and approval, policy on financial restructuring involving federal credit or otherwise impacting budgetary scoring, and implementation guidance for legislative requirements such as section 606 of the John S. McCain National Defense Authority Act of Fiscal Year 2019 (Public Law 115-232) which requires payment to MHPI projects to make up for reductions in housing allowances as part of incorporation of an out-of-pocket component. My staff reviews and provides scoring documents and consultation necessary to obtain OMB approval of new MHPI projects or changes to project deal structures that could potentially impact project budget scoring or federal credit subsidies. These changes, that could revise government financial contributions or property conveyance or impact federal credit instruments, include restructures of government direct loans; changes to private loans covered by government loan guarantees; and sales of projects or project assets and use of sale proceeds.

A key aspect of OSD's oversight is long-term monitoring of the financial health of the individual projects and MHPI portfolio as a whole. This includes implementing new or improved procedures to provide enhanced housing privatization reports on an annual basis to the congressional defense committees, to include an assessment of project sustainment; establishing and monitoring performance metrics and key project data elements; and conducting periodic program reviews to identify project or program issues that necessitate increased monitoring, additional guidance or assistance from OSD or by the Military Departments, or potential resolution through some other change to the project such as a financial restructure.

Under my leadership, OSD is increasing its oversight to ensure the Military Departments fully and effectively exercise their responsibilities to ensure that privatized housing is managed in a manner protective of human health and the environment. This includes OSD establishing new reporting requirements and programmatic reviews regarding Military Department monitoring of potential hazards in privatized housing, such as reporting on the number of child falls from windows in MHPI (or military-operated) housing.

Additionally, OSD is increasing its participation in meetings with MHPI partners to focus on privatized housing management, housing conditions, and project financial health from a portfolio perspective. On February 1, 2019, I hosted a meeting with MHPI partner and Military Department executives to review their oversight of housing conditions and discuss how we can work together to better ensure local privatization project housing managers are responsive to tenant concerns, remedy identified health or safety hazards, inspect housing for hidden hazards in need of resolution, and keep residents informed regarding any safety risks and associated mitigation or abatement measures. As a result of this summit, the DoD participants and MHPI partners collectively agreed that a way forward in addressing resident concerns will focus in three key areas...communication, engagement, and responsiveness.

The Department and our housing privatization partners are committed to working together to increase our collective communication with military families to better ensure they have a positive experience living in privatized housing. This includes increasing our engagement with military families throughout their entire residency in privatized housing. For example, meeting with residents within 90-days after their lease signing to ensure they are satisfied with their home and overall housing experience, hosting more frequent townhall meetings, and providing other opportunities to solicit feedback besides annual resident satisfaction surveys.

Through increased engagement, we will better educate military families about their roles and responsibilities to help identify any issues with housing conditions, and the roles and responsibilities of the privatized partner and the installation housing teams. Our commitment to increase engagement also extends to Military and Veteran Support Organizations and advocacy groups such as the Military Family Advisory Network.

In all cases, we commit to work with our housing privatization partners to ensure any and all resident concerns are addressed in a highly responsive, timely and professional manner, with emphasis on expediting resolution of any concerns involving potential health or safety issues. We want our military families to know that we truly care about their experience living in

privatized housing and that we want to collectively do better in delivering safe, high quality, affordable housing where our military members and their families will want and choose to live.

Overall Health of the MHPI Program

The overall health of the MHPI program is measured in three distinct phases: Initial Development, Sustainment, and Recapitalization.

Initial Development Phase (IDP): This phase is typically planned for the initial 5 to 10-year period after project financial closing. With 99 percent of the initial development complete, more than 62 percent of the MHPI portfolio is either newly constructed or has received a major renovation with the remaining housing receiving some investment (e.g., new cabinets, paint, new flooring) to ensure the housing is in good condition. The MHPI program has leveraged private sector capital by a ratio of 8 to 1, achieving more than \$32 billion in development scope with just \$4 billion in government funding. While the majority of IDPs are complete, the resulting leveraging of private sector investment is far in excess of the original internal DoD requirement to achieve projects with a 3 to 1 leverage, and represents a highly successful and a very healthy foundational start to the program.

Sustainment Phase: This phase begins after the IDP, concentrating on operation of the asset and planned capital repair and replacement is the norm as the project pays down the initial financing and begins to save for the next major recapitalization development period which will likely occur around year 25 to year 30 of the project. While the MHPI program is in the early stages of this phase, the program remains very healthy with strong occupancy across the portfolio, positive resident satisfaction and, for the most part, strong cash flows to support the initial debt taken down by the projects.

The projects of the most concern at this point are those that were highly leveraged at the outset, most notably the projects with government direct loans (GDL) in addition to their private debt. This government financing is generally subordinate to the third-party financing and results in the greater risk that the project might lack sufficient cash flow to cover project debt in the event that project revenue is lower than expected. This can occur if housing occupancy or BAH rental income is lower than expected, for example, due to deployments, and/or if operating costs are higher than projected, for example, due to significantly increased utility rates. The focus of oversight in situations where the GDL is at risk is on restructuring or modifying the GDL to ensure, first and foremost, repayment of the principal and secondly to preserve as much of the original interest return anticipated at the outset of the loan.

Recapitalization Phase: Recapitalization of the assets at the appropriate time in the life cycle is a bellwether measure of the overall success of the MHPI program. At this time, it is too early to determine if a project is able to meet recapitalization objectives as there is significant time remaining in the Sustainment Phase. Further, there are other changes occurring or affecting each project that impact the funds available at the time Recapitalization Phase begins. That said, prudent management of the projects includes frequent forecasting of funds available in relation to anticipated costs of the recapitalization. In addition, the MHPI authorities and the existing project structures provide tools to address potential funding shortfalls. As such, we cautiously,

but reasonably, assert that the program will remain healthy as we approach and proceed through this phase.

To ensure continued health and success, long-term government oversight of the program and individual MHPI projects is critical. The private sector brings exceptional experience and expertise to perform a non-core function for the Department of Defense. However, we must recognize that the Government's interests are not always aligned with the private sector; oversight and engagement is required and expected in a public-private partnership over the long term to ensure success.

Health and Safety Conditions in Privatized Housing

Although privatization has dramatically improved the quality of on-base housing, there is room for improvement, including in those areas raised in recent media coverage. DoD, the Military Departments, and our privatization partners take seriously any concerns about unsafe or unhealthy conditions in privatized housing and are committed to addressing such concerns. The health and safety of our Service members and their families is a top priority of the DoD. With that said, in some cases, we lost focus on delivering a positive experience to our residents.

While MHPI resident satisfaction surveys by an independent third party (with occupancy rates that exceed 93 percent for all MHPI projects) suggest the recently raised issues are not indicative of a systemic problem across the MHPI portfolio, the Military Departments and MHPI project partners continue to work together to review housing conditions. They are working together to address health and safety hazards, and to evaluate policies and procedures to ensure that any health and safety issues are addressed in a manner protective of human health and the environment, in compliance with all applicable federal, state, and local laws and regulations, and applicable DoD and Military Department policies. In all cases, it is my expectation that the Military Departments and housing privatization partners keep residents informed about lead-based paint, mold, or other hazards, and associated mitigation or abatement measures. The Military Departments will continue to assess privatized housing tenant satisfaction through resident surveys obtained using an independent third party contractor and will incorporate the survey results into their reviews of partner performance.

MHPI project ground leases and associated legal documents address the requirement for projects to provide safe, quality housing and define required project compliance with Federal, state and local environmental and health standards. MHPI projects must comply with the same regulatory standards and inspection requirements as off-base rental housing and tenants of privatized housing have the same rights and protections as residents living off-base. While there are Federal regulations and standards related lead based paint, there are no Federal standards for mold. The Military Departments and their housing privatization partners consider all housing maintenance requests including those involving lead-based paint or mold as "urgent" and therefore requiring rapid response.

Each Military Department has procedures in place, supported by their respective housing offices, through which military tenants may seek assistance to resolve issues with their landlords, whether they live in private housing off-base or privatized housing on-base. Residents of

privatized housing are encouraged to report any concerns to the housing property management office or the on-base, government housing office so that their concerns can be addressed in a timely manner. All resident complaints will be taken seriously and acted upon in a timely manner. Residents of privatized housing also have the option of filing an anonymous complaint with the Inspector General. In all cases, the installation commander is the resident advocate for any issue involving privatized or government-owned or leased housing and is always to act on behalf of the resident, without resident fear of reprisal.

Prospective tenants of any privatized (or government-owned or leased housing unit) built before 1978 are notified in writing of the health risks associated with damaged or deteriorating lead-based paint and what to do if any damage to paint occurs, consistent with EPA requirements. Before signing a lease and accepting residency, prospective tenants are: 1) provided with EPA-required information about the presence of lead-based paint, health risks associated with lead exposure, the steps they must follow to minimize those risks, the requirement to notify maintenance if any damage or deterioration to paint occurs while they are living in the home; and 2) required to review and sign a lead paint addendum that is consistent with EPA requirements. Because Service members are not required to live in MHPI housing, they can opt not to rent privatized housing, or a specific unit of privatized housing, for any reason. For example, a Service member might decline to rent a privatized housing unit that was built prior to 1978 due to concerns regarding potential lead-based paint.

Unfortunately, we are seeing anecdotal information indicating that not all residents fully understand or appreciate the need for their vigilance that these standard documents seek to convey; but rather view them as one of a litany of forms they must sign in the chaos of a Permanent Change of Station (PCS) relocation. Accordingly, the Military Departments are exploring a variety of educational programs, including 90-day post move-in visits and interviews to impress upon residents, in a time of more calm, the need to be watchful for and promptly notify management of any damaged or deteriorating lead-based paint.

The Government Accountability Office (GAO) has initiated a review of hazards in privatized housing. We welcome this review and stand ready to work with the MHPI partner companies to provide GAO with the data needed to make informed judgments on the management and benefits of this critical program.

Conclusion

The Department of Defense understands that family is important and honors the sacrifice that Service members and their families make to serve our nation. The Department recognizes we have a moral obligation to military families to provide safe and quality housing, and we take that obligation seriously. We are committed to the long-term success of the MHPI projects and MHPI program, and will continue our oversight of the MHPI portfolio to ensure delivery of quality housing for Service members and their families over the life of the projects. Bottom line, this includes a twin focus...ensuring our residents have a positive experience living in privatized housing, and ensuring the long-term viability of the MHPI projects.

Thank you for the opportunity to testify on the Military Housing Privatization Initiative and for your continued support of Department of Defense's efforts to make sure that military families have safe, quality housing. Again, I look forward to working with you to support the priorities of the Department and the quality of life for our military members and family members who are called to sacrifice so much for public service.