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Statement of

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(Sustainment)**

**Before the House Committee on Appropriation
Subcommittee on Military Construction, Veterans Affairs, and Related Agencies**

on the

Military Housing Privatization Initiative

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Introduction

I want to thank you Chairwoman Wasserman Schultz, Ranking Member Carter, and distinguished members of the subcommittee. I am honored to appear before you this afternoon in my capacity as Acting 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.

Since February 2019, the Department's focus has been, and continues to be, on corrective actions to enhance the Military Housing Privatization Initiative (MHPI) program, consistent with our commitment to ensure housing privatization projects provide safe, quality, well-maintained housing for military members and their families. Key within this is our effort to rebuild trust with our military families. The recently issued MHPI Tenant Bill of Rights and MHPI Tenant Responsibilities document are visible and important commitments in DoD's larger effort to regain resident trust. These represent a foundational step of our ongoing improvements to the Department's privatized housing program. In addition, the Secretary of Defense recently designated the Assistant Secretary of Defense for Sustainment as the Chief Housing Officer (CHO) to serve as the lead within the Department for overall housing privatization program oversight. The CHO's principal duties will include creation and standardization of policies and processes regarding privatized housing, and oversight of the administration of any Department-wide policies regarding privatized housing. The Military Departments will continue to execute oversight of their respective MHPI portfolios. We 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

The Department remains confident that housing privatization was the right thing to do, and with continued diligence from all, can return to the success enjoyed over the first 20 years of the program. Privatization has dramatically improved the quality of on-base housing and has provided mechanisms for the long-term investment necessary to maintain high quality affordable housing where our military members and their families want and choose to live. As we continue to identify and address challenges within the program, we must remember how we got here.

Prior to the establishment of the MHPI, the quality of housing on our U.S. installations was poor. We had a \$20 billion maintenance backlog, which would take an estimated 30-plus years to address using traditional military construction and funding. The lack of quality housing was severely impacting Service member quality of life, creating recruitment and retention challenges and affecting readiness. These realizations contributed to the Department's conclusion that leveraging private sector expertise and funding would improve housing quality much faster than we could provide by maintaining this housing as DoD-owned.

This led to the enactment of the MHPI in the Fiscal Year (FY) 1996 National Defense Authorization Act (NDAA). Under this initiative, the Military Departments conveyed existing government family housing units on U.S. installations to competitively-selected entities (i.e., the

MHPI projects). Since most Service members have a choice between living on or off base, the projects would compete with housing in the local community, creating an incentive for the project owners to invest their own resources to maintain quality housing to attract and retain tenants.

At present, the MHPI consists of 79 family housing projects across approximately 150 installations. Combined, these projects cover over 200,000 housing units, or 99% of on-base housing available to families in the United States. These projects operate under long-term (~50-year) ground leases, generally with one additional 25-year option period, and associated legal agreements with a Military Department. In return, the MHPI projects own the housing and are responsible for operation, maintenance, construction, and replacement of the housing during the lease term.

It is important to note that the private MHPI partners operating these projects are not DoD or Military Department contractors. The MHPI projects are private business entities and our relationship with them is not governed by federal acquisition regulations. The Military Departments retain oversight and limited decision-making rights through the project legal agreements. The government cannot unilaterally change a project legal document. When changes are pursued, in addition to project owner consent, the project lender also retains approval rights to project legal document changes.

The Military Departments monitor the MHPI projects to ensure adherence to the terms of the project documents, as well as applicable legal and regulatory requirements, and to ensure project financial performance can sustain quality housing over the life of the ground lease term. To this end, 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, 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.

Military Housing Privatization Past/Current Progress

At present, 99 percent of the construction and renovation planned for the initial development period (IDP) of the individual MHPI projects has been completed, to include construction of nearly 80,000 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 financial contributions as authorized under the MHPI authorities.

Since early last year, DoD has been working to address the concerns of our military families. We recognize and acknowledge that our oversight of the program had not been up to the standards established at the outset, including engagement at all levels throughout DoD. This oversight was the cornerstone of the success enjoyed over the first 20 years of the program. We believe that the reapplication/reconstitution of oversight will both restore trust with military families living in privatized housing and enhance the spirit of collaboration with

our private sector partners that is critical to ensuring the viability of the program well into the future. Our efforts are concentrated into the following key oversight areas:

1. Senior Leader Engagement
2. Rebuilding Trust
3. Accountability
4. Transparency and Communication
5. Financial Viability

The following summarizes DoD and Military Department actions completed or underway on each of these areas during the past 12 months:

1. Senior Leader Engagement: The success enjoyed by the MHPI program during the first 20 years allowed DoD personnel at all levels, from the installation through headquarters, to focus attention on core mission functions. While this approach was in line with the vision for privatization, it resulted in a delay in recognizing fundamental and systemic concerns expressed by a small but increasing minority of residents. Since early 2019 senior leadership within DoD has been actively engaged to resolve the immediate challenges as well as reform the oversight processes to ensure that these challenges are not repeated in the future. In addition, we acknowledged lapses in oversight throughout the chain of command during testimony before the Senate Armed Services Committee (February 2019) and House Armed Services Committee (April 2019). I pledge to continue the open dialog with Congress that we have already established.

Our office established and has led, since early 2019, a weekly MHPI Task Force meeting comprised of the Military Department Assistant Secretaries who oversee MHPI programs to identify, track, and implement MHPI corrective actions and enhance program oversight both in the short term and in the long term. We established, together with our Military Departments, a quarterly meeting with MHPI partners to maintain senior leadership engagement to collaboratively engage on housing issues and corrective actions. DoD also established a quarterly meeting of the Secretary of Defense, Service secretaries and chiefs and the senior leadership of the MHPI partners to report progress, resolve any significant impediments, and discuss potential opportunities to enhance the resident experience.

Our office is collaborating with the Office of the Under Secretary of Defense for Personnel and Readiness in a senior-level DoD working group to review the process for computing annual Basic Allowance for Housing rates. In addition, we are working with the Assistant Secretary of Defense for Health Affairs to ensure Military Department medical care procedures are adequate and responsive to military families' health concerns related to hazards such as mold, radon, and pests that are sometimes encountered in privatized homes.

The Chief Housing Officer (CHO) will maintain the enhanced level of DoD senior leader engagement with the MHPI partners by continuing to hold quarterly Tri-Service roundtable meetings and quarterly meetings with the senior leaders of the MHPI partners. We will promulgate and institutionalize the MHPI Task Force to facilitate condition-based meetings

focused on program metrics and the status of corrective actions to foster collaboration and drive consistent improvement across the program.

2. Rebuilding Trust: We acknowledge that significant concerns went unaddressed for an unacceptable period of time. Rebuilding trust with service members and their families will take time and we are committed to this effort. A significant element of rebuilding trust is in the establishment of an MHPI Tenant Bill of Rights as well as the MHPI Tenant Responsibilities documents. These documents will help provide consistency across the program for all residents, many of whom live on multiple installations during their career.

The Department's version of a Resident Bill of Rights included input from more than 190,000 then-current MHPI households, Congress, MHPI partners, and military and veteran support organizations. The DoD version of the Resident Bill of Rights was aspirational and we were actively working with the MHPI partners to develop implementing guidance. However, the enacted NDAA for Fiscal Year 2020 included significant modifications of, and additions to, the MHPI legal framework, which rendered the prior progress on the Resident Bill of Rights and Resident Responsibilities legally insufficient. Similarly, the Department was working with the MHPI partners on processes for dispute resolution and rent withholding, as well as a common lease framework that were superseded by detailed provisions in the NDAA.

The MHPI Tenant Bill of Rights has now been issued with a commitment to provide full benefits for 15 of the 18 rights outlined in the NDAA by May 1, 2020. With respect to the remaining three rights—access to maintenance history, process for dispute resolution, and withholding of rent until disputes are resolved—the Department will continue to work with the MHPI companies and, as necessary, Congress to ensure the benefits of these rights are fully available as quickly as possible.

3. Accountability: A key element of concern expressed throughout the past year is related to how MHPI partners as well as other direct stakeholders are held accountable for resident concerns. A common view is that contractors can be terminated and/or debarred for failing to deliver under contracts, so why can't MHPI partners be held to the same standard? The simple answer is that MHPI project owners are not government contractors; they are private business entities and our relationship with them is not governed by federal procurement regulations. However, DoD recognizes the need to bring greater accountability to the program not only with the MHPI partner staff at the projects, but also with stakeholders involved in DoD's project oversight at all levels.

As a result, DoD issued an incentive fee policy that established a common performance incentive fee framework across the MHPI project portfolio that the Military Departments are now implementing to ensure incentive fee metrics for individual projects reflect the importance of service work responsiveness and customer satisfaction. In addition, the MHPI Task Force developed MHPI program metrics for the Secretary's Weekly Priority Review, to ensure visibility and tracking of MHPI financial and resident satisfaction as measures of MHPI program performance.

In order to improve accountability at the MHPI projects, the Military Departments issued directives to each of the MHPI project owners to discontinue use of certain non-disclosure agreements that, in several cases, were used improperly to deter residents from reporting problems with substandard homes.

The Assistant Secretary of Defense for Sustainment directed the Military Departments to review each of their MHPI projects' business practices (e.g., the processing of maintenance records and other performance assessment-related data) for appearances of inappropriate handling of data that informs Military Department decisions regarding incentive fees payments and the need to take corrective measures to address individual project performance. These reviews performed by the Military Departments identified 15 cases of retaliation or concerns of potential retaliation, with some cases not fully resolved, by MHPI project company staff or installation personnel against privatized housing residents after they reported unsatisfactory housing conditions. In some instances MHPI property management employees faced disciplinary actions as appropriate. The Military Departments also directed audits of incentive fee awards at some MHPI projects. The audits did not indicate a systemic, widespread problem, but resulted in one MHPI partner terminating 17 employees for falsifying work order completion reports to collect higher performance incentive fees.

4. Transparency and Communication: Efforts to improve communication with residents and other stakeholders include my office conducting multiple resident town hall sessions, visiting six installations with tours of privatized housing, and holding multiple meetings with military and veterans support organizations, senior leader spouses, and the Military Family Readiness Council. The Military Departments also increased direct military family contact by also conducting resident town halls at each installation. The Service Secretaries and Chiefs directed installation leadership to contact 100 percent of residents to hear their concerns and conduct, or offer to conduct, home condition inspections. In addition, the Military Departments implemented 24-hour hotlines allowing MHPI residents to register issues or complaints regarding MHPI service received, or health concerns that may be related to MHPI housing.

A key failing of the oversight of MHPI housing was the lack of adequate government housing staff on installations. To address this shortfall, the Military Departments increased manpower authorizations in installation housing offices and accelerated the hiring of about 500 additional staff and advocate positions to augment oversight, quality assurance, and customer care services.

In order to improve communication and transparency with residents, and enhance program oversight of the handling of maintenance issues, the Military Departments directed MHPI partners to provide online and/or mobile app-enabled maintenance web portals, allowing residents to enter, monitor, and provide feedback on housing work orders. My office, in coordination with the Military Departments, continues to facilitate and participate in resident town hall meetings and listening sessions. Additionally, we continue regular communication with Congress, the MHPI partners, and military and veterans support organizations to ensure the Department's actions have the support of all of our stakeholders.

5. Financial Viability: A critical component of long-term success is the financial viability of the MHPI projects. The projects receive operational funding principally from the rent paid by the residents that choose to live in MHPI housing. The MHPI projects leveraged this income stream to achieve more than \$32 billion in total development with less than \$4 billion in government funding, as authorized under the MHPI authorities.

In 2015, the Department made a decision to reduce BAH by 1% per year over a 5-year period. The implementation of the out-of-pocket initiative negatively impacted MHPI projects because, unlike off-post private housing, the MHPI projects are prohibited from charging rent that exceeds the members BAH. The BAH reduction required MHPI projects to reduce ongoing operating expenses and/or reduce funding for the capital repair and replacement of the homes. To help mitigate the impact to MHPI projects, Congress directed DoD to make subsidy payments to MHPI projects beginning with the National Defense Authorization Act for Fiscal Year 2018, and increased the subsidy payment to 5 percent for Fiscal Year 2019. These subsidy payments are currently utilized to fund MHPI project expenses, including maintenance and repairs of homes to address resident concerns.

While the initial capital raised by the projects prioritized construction of nearly 80,000 new homes, and significant renovations of over 50,000, there were nearly 70,000 homes that received less substantial improvements. The funds available at the MHPI project, were carefully analyzed in relation to the condition of the homes at transfer to determine the optimal initial development scope for each project. The initial development scope addressed the near-term immediate requirements while ensuring the financial viability to meet the housing improvement requirements over the long-term. Beyond the initial development, any decisions made by the government as well as legislative changes to the ongoing operation of the MHPI project will directly impact the funds available for future renovation and replacement of the homes and/or the repayment of outstanding government loans. As such, legislative and policy changes with implications to MHPI project operations must be coordinated with the MHPI partner to assess the long-term financial implications. Depending on the outcome of the analysis, the proposed change will likely require lender consent prior to implementation.

Another financial oversight role for my office relates to government direct loans utilized by the projects to provide additional capital for development. Government direct loans are a tool used by the Military Departments to increase renovation and replacement of homes during the initial development period by leveraging future project cash flows in much the same manner as the third party loan. These loans made by the Treasury were subsidized by the Military Departments due to higher credit risk, typically subordinate to the third-party loan, and below market interest and repayment periods. Infrequently, but in certain circumstances, a project may be unable to sustain the direct loan under the original terms despite efforts by the Military Department and MHPI partner to implement corrective actions at the local level to improve a project's finances. My office, in coordination with the affected Military Department, will review and prepare a proposal for Office of Management and Budget approval to adjust the terms of the government direct loan in conjunction with MHPI partner concessions in order to restore long-term project viability and sustainment.

While significant progress has been made over the past year, we acknowledge that we still have more work to do to restore the trust of the residents. In addition, we recognize that the most critical element of these efforts is to sustain our focus on long-term project and program oversight. No public private partnership on the size and scale of MHPI can succeed over the long-term without encountering challenges along the way.

MHPI Provisions in National Defense Authorization Act for Fiscal Year 2020

As you are well aware, the FY 2020 NDAA includes significant reforms for the Military Housing Privatization Initiative. With 39 sections containing over 100 provisions, Congress has taken robust action on behalf of Service members and families living in privatized military housing. The Department thanks the congressional defense committees for their leadership in this area, as well as the opportunity to provide input to development of the bill. While DoD understands and appreciates the intent of the legislation, there are elements that create challenges and/or complications for implementation.

As previously mentioned, MHPI projects are not contracts governed by traditional federal acquisition regulations, but rather are complex, public-private partnerships that are captured in a variety of legal documents that constrain both parties. The Government does not have the legal authority to unilaterally change the terms of the deal. Congress recognized this condition in the FY 2020 NDAA by requiring the Secretary of Defense to seek agreement from the MHPI landlords (i.e., the MHPI project companies) to voluntarily agree to retroactive application of certain provisions to existing MHPI projects.

In addition to gaining consent from the MHPI partners, some changes to the projects require the approval of the projects' lenders and/or bondholder representatives. The MHPI project companies, not the MHPI partners, secure private sector debt. The MHPI projects' private sector debt is non-recourse to the Government, meaning that in the event of a project default the debtholders cannot seek recovery of the loan from the Government. The exception is the MHPI debt where the Government has provided a limited Government Loan Guarantee, currently in place at nine projects. However, there are specific criteria that must be met for those limited Government Loan Guarantees to be utilized. Therefore, structural changes that place risk on a project's cash flows are a concern to the lenders and bondholder representatives since they could impact the project's ability to pay its debt obligations.

The need to gain approvals from the MHPI projects' private-sector stakeholders combined with the Department striving to ensure a positive resident experience for Service members and families necessitates taking time to thoughtfully develop and implement the FY 2020 NDAA MHPI provisions.

Since enactment of the FY 2020 NDAA, DoD has been working with the MHPI partners to implement those items previously underway as well as address newly created items not previously contemplated. Many of the reform provisions in the FY 2020 NDAA were well under way prior to enactment. There are many details to work through to ensure compliance with the legislation in a manner that can be implemented with the agreement of both our MHPI partners as well as the projects' bondholder representatives. As a related issue, The Department is

concerned about the new financial requirements placed on the MHPI projects by the FY 2020 NDAA and will monitor their impact.

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 remain committed to the long-term success of the MHPI program, and will continue to remain diligent in our oversight 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...striving to ensure our residents have a positive experience living in privatized housing, and working to ensure the long-term financial viability of the MHPI projects.

Thank you for the opportunity to testify on this critically important topic 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 continue to work 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.