



DEFENSE BASE CLOSURE AND REALIGNMENT COMMISSION

2521 South Clark Street, Suite 600

Arlington, VA 22202

Telephone: 703-699-2950

August 22, 2005

TRANSMITTAL MEMORANDUM

TO: Chairman

FROM: Office of the General Counsel

SUBJECT: Revised Memorandum Re: Navy's Privatized Housing
(Northeast Project)

Enclosed please find a revised memorandum describing the transactional structure and analysis of the Department of Navy's Northeast Project, a privatized housing project comprised of eight properties, including New London, Portsmouth and Brunswick. These three installations appear on 2005 BRAC list of proposed closures or realignments. This memorandum provides additional and amplified analysis based on subsequent staff discussions with the Navy's office for privatized housing initiatives, and review of the Navy's responses to clearinghouse questions submitted by staff members.

Specifically, in answer to your question regarding the nature and amount of the Navy's potential (unfunded) contingent liability if the three properties in question are closed through the BRAC process, please note that the Navy will *not* incur any additional financial liability with respect to the Northeast Project. Further, BRAC staff members have determined, based on certified information submitted by the Navy, that the Navy has made a one-time contribution in-kind that conveyed in fee the fair market value of the housing units and improvements (not the underlying land) to the limited partnership that has organized the Northeast Project. The amount of this contribution is estimated by the Navy to be approximately \$285 million, of which \$110 million represents the contributed assets for the three BRAC-listed installations. Although this amount was not calculated in the COBRA run by the Navy, the value of this in-kind contribution is potentially recoverable by the Navy through a partial (or complete) sale of its partnership interest in the Northeast Project.

The detailed explanation of this conclusion is set forth in the memorandum prepared by Rumu Sarkar, Associate General Counsel, and Brian McDaniel, R&A, Navy Team, who will both be happy to answer any further questions that you may have.

DAVID C. HAGUE
General Counsel

Chairman: Anthony J. Principi

Commissioners: The Honorable James H. Bilbray, The Honorable Philip E. Coyle III, Admiral Harold W. Gehman Jr., USN (Ret), The Honorable Jim Hansen, General James T. Hill, USA (Ret), General Lloyd Newton, USAF (Ret), The Honorable Samuel K. Skinner, Brigadier General Sue Ellen Turner, USAF (Ret)

Executive Director: Charles Battaglia

August 23, 2005

INFORMATION MEMORANDUM (REVISED)

FROM: Rumu Sarkar, Associate General Counsel
Brian McDaniel, R&A (Navy Team)



SUBJECT: Navy's Privatized Housing Initiative (Northeast Project)

EXECUTIVE SUMMARY: The question has been raised of whether the Navy's Northeast Project, a privatized housing initiative, may create unfunded contingent liabilities if three Navy installations that participate in that housing project are closed (or realigned) as a result of 2005 BRAC round. Concerns have been expressed that significant (unfunded) contingent liabilities may arise for the Navy in connection with the Northeast Project, and were not taken into account when the Department of Defense made its cost calculations and estimated cost savings.

The Navy has made a one-time conveyance in fee to the underlying private-public partnership supporting the Northeast Project of the housing assets contained within the Project. The Navy estimates that this conveyance was worth approximately \$285 million, with approximately \$110 million of that amount representing the Navy's one-time contribution for the Brunswick, Portsmouth and New London properties. This conveyance in fee was made by the Navy on November 1, 2004.

The Navy also issued a 50-year ground lease to a private developer for the use of the real property underlying the housing units in question. However, the Navy has retained title to the land supporting the housing units in the Northeast Project. All subsequent improvements to the Northeast Project housing units were fully financed by the private developer using the proceeds from the sales of bonds issued by the partnership. These improvements do not involve any additional financial contributions, contributions in-kind or legal liability on the part of the Navy.

Therefore, this memorandum concludes, based on an exhaustive review of underlying transactional documents and an analysis of the clearinghouse responses provided by the Navy in answer to queries posed by BRAC staff, that it is unlikely that the Navy will incur an unfunded contingent liability (or incur a substantial one-time termination cost in COBRA) with respect to the Northeast Project, even if the Navy's partnership interest in the Project is terminated due to BRAC closures. This conclusion is supported by the discussion below.

A. OVERVIEW: The Military Housing Privatization Initiative (MHPI) is a public-private partnership whereby private sector developers may own, operate, maintain, improve and assume responsibility for military family housing under circumstances where national security is not adversely affected.

The MHPI was enacted on February 10, 1996, as part of the National Defense Authorization Act for Fiscal Year 1996, and these authorities were made permanent by Congress in 2004. Under the MHPI authorities, the Department of Defense (DoD or the "Department") can work with the private sector to revitalize and create military family housing by using a financial "toolbox" -- including direct loans, loan guarantees, equity investments, and conveying or leasing military property or facilities. The National Defense Authorization Act for Fiscal Year 2005, Public Law 108-375 107, Section 2805, provided permanent authorities to the Military Housing Privatization Initiative, as codified at 10 U.S.C. § 2871, *et seq.*

Since the MHPI was enacted in 1996 following the completion of the 1995 BRAC Round, the issue of privatized housing under that legislation was not raised during the course of any previous BRAC Commission. However, the Commission is aware that the 1995 BRAC Round did have a substantial number of staff files discussing privatized housing matters.

In essence, the MHPI, as amended, allows DoD to legally enter into or become a member of a non-governmental special or sole purpose (and bankruptcy remote) entity created exclusively for the purpose of financing, building, owning, operating, and maintaining rental housing for the benefit, on a priority occupancy basis, of military members and their families. These special purpose entities can take the form of a limited partnership into which DoD is authorized to provide appropriated funds (i.e., cash) or contribute other valuable assets including land and existing DoD owned family housing units in order to enhance the partnership's ability to attract and borrow the substantial amount of private equity needed to rehabilitate and/or build new housing on government-owned property.

These "partnerships" -- as organized in legally authorized structures including Limited Liability Corporations (LLCs) -- are created as independent legal entities by a competitively-selected private housing developer, and are legally separate from the Department. In other words, DoD incurs limited legal liability as a result of its membership in such partnerships, thereby permitting DoD to comply with existing federal laws and budget scoring restrictions. At the same time, these legal arrangements free the Department from the burden of having to budget and expend limited capital and operating funds on the construction, operation and maintenance of DoD-owned family housing units.

Further, since the individual military services have agreed to enter into these public-private ventures as limited liability members, the member Services and the DoD are legally shielded from the entity's legal, business, and financial obligations. Although DoD retains some approval rights affecting the quality and management of the housing, the Department does not participate in the daily management and operation of such partnerships.

Although no minimum cash contribution has been set for any DoD investment in a project, there is a maximum cash contribution established by law. Under Section 2875(c) of the MPHI, the Department may invest a maximum of 33.3% of the capital cost of a project. Since all sites and projects differ, and because the services each prioritize their own projects, the full 33.3% cash contribution may not be needed in each project. However, DoD also has the authority to convey land or buildings as all, or part, of its investment. If it chooses this route, it may not exceed 45% of the total capital cost if land or facilities are conveyed. (*See* 10 U.S.C. § 2875(c) (2)). Thus, for projects involving renovation, replacement, and support facilities, DoD's total equity contribution may not exceed 45% of a project's capital cost.

B. NAVY NORTHEAST PROJECT: In early 2004, the Department of the Navy (DON) awarded a family housing privatization project with a total development cost of \$617.8 million for the privatization of 4,264 net units at installations managed by Navy Region Northeast. As part of the transaction, the developer and the DON formed a Limited Liability Corporation (LLC) to borrow funds in addition to the cash or in-kind contributions made by the private developer and the DON, so that the LLC would have, or would be able to secure, all the financial resources needed to execute its development plan as well as manage and maintain the privately-owned rental housing on government – owned property leased by the Navy to the private developer. In return for the 50-year government lease, the private developer has promised to develop, or caused to be developed, market rental housing for use by military member and their families at the following Navy installations:

- NSB New London, Croton, CT (1,796 units)
- NAS Brunswick; Brunswick, ME (723 units)
- NSY Portsmouth, NH (223 units)
- NWS Earle, Colts Neck, NJ (89 units)
- NAES Lakehurst, Lakehurst, NJ (114)
- Mitchell Manor, Long Island, NY (250 units)
- NS Newport, Newport, RI (869 units)
- NSU Saratoga Springs, Saratoga Springs, NY (200 units).

On November 1, 2004, the Navy entered into a 50-year land lease, conveyed ownership of existing houses, and became a non-managing member of the Navy Northeast LLC. Concomitant with lease execution, the LLC borrowed the balance of the money it needed to begin design and construction activities at the various locations. After the developer completes the housing projects, it has agreed to lease the units, on a priority basis, to Navy members assigned to the various housing units. Members, in turn, can select to rent housing from the LLC using their basic allowance for housing (BAH) to cover all, or a substantial portion, of the rent.

In response to further clearinghouse questions posed by the BRAC Commission staff, the DON has clarified that the value of its contributed assets to the Northeast Project was not calculated in terms of the fair market value (FMV) of such assets (e.g., improvements on the property), but in terms of the depreciated value of the value of the housing units, or

the so-called "book value," as calculated for Federal income tax purposes. The book value for all housing assets in the Northeast Project (excluding the FMV of the land on which the housing units are located) is estimated by the DON to be approximately \$285 million. For the specific Navy installations under consideration in the 2005 BRAC round, the book value estimates by the Navy are as follows:

Brunswick	\$42.3 million
Portsmouth	\$4.4 million
New London	<u>\$63.5 million</u>
	\$110.2 million

The DON has *not* funded any of the improvements that may have been made to the eight properties in the Northeast Project, namely, Brunswick, Earle, Fairfield, Lakehurst, Mitchell, New London, Newport, Portsmouth, and Saratoga Springs. Any improvements made to any of those properties were (and will continue to be) completely financed by the private developer through the use of the bond proceeds.

Out of the LLC's total project development budget of \$617 million, the LLC borrowed \$517 million (84% of the total budget) by issuing and selling unregistered taxable revenue bonds to private institutional investors. This private placement by the LLC allows it to use all the borrowed funds along with its upfront cash contribution of \$10.6 million (2% of the total budget), plus another \$89.4 million (14% of the total budget) generated by either reinvestment income of bond proceeds or annual residual cash flows (on a pro forma basis), to complete the housing net units planned for each of the eight sites.

Of the \$617 million project budget, the LLC plans on using \$581 million, or 94% of the project budget to cover design and construction costs including contingencies; \$15 million to fund investor-required project and investments reserves, and about \$6 million for housing transition costs. The balance of the funds, or about \$15 million, was used to pay the LLC's closing and legal costs.

The 2005 BRAC round recommendations involve, *inter alia*, complete closures of NSB New London and NSY Portsmouth, and substantial realignment (or closure) of NAS Brunswick. In light of this fact, the issue of whether these potential closures create an unfunded contingent liability for the DoD, and whether these potentially implicit costs should have been added in the COBRA analysis has been thoroughly explored by BRAC staff. The DON has responded to questions posed by BRAC Commission staff members by providing certified data through the clearinghouse. These responses have been taken into account (and entered into the public record) by the BRAC staff. (See Tab 1.)

In its certified data response dated August 22, 2005, the DON assures BRAC staff members that the DON is not required under the MHPI to withdraw from the LLC, even if one or more of the constituent properties is closed as a Navy housing unit. Further, the Navy has made the representation that the Northeast Project also includes installations

that would not see a decrease in military personnel as a result of BRAC recommendations.

Nevertheless, if the DON's partnership interest in the LLC were dissolved, then the Navy advises the BRAC Commission that two possible courses of action are available to it vis-à-vis the Northeast Project. First, the Navy could liquidate its partnership interest and seek to dissolve the LLC if the Navy first obtained lender approval and satisfied all outstanding debts. If this avenue were pursued, the DON assures the BRAC staff that, "there would be no cost to the Navy with [the] liquidation of the partnership." (See Tab 2.)

The Navy's second option would not dissolve the LLC. Instead, the Navy would request the managing member (i.e., the private developer) to purchase, at FMV, the DON's partnership interest in the LLC. In either scenario, the Navy represents that there would not be any unfunded contingent liability on the part of the Navy. The discussion below examines the transactional structure of the Northeast Project in further detail.

C. NORTHEAST PROEJCT TRANSACTION STRUCTURE: The DON entered into a limited liability corporation, the GMH Military Housing -- Navy Northeast LLC, a Delaware corporation, as a member. (The DON has also agreed, as set forth in Section 8.17 of the Operating Agreement of the Northeast Housing LLC, that the GMH Communities Trust will make an initial public offering (IPO) of securities, and will succeed to the GMH Military Housing, LLC in due course.)

The private developer is the managing member of the LLC. The DON is a non-managing member of the LLC and, in that capacity, has pledged a 50-year leasehold interest in the property to the LLC. This is not a cash or equity investment, but simply a pledge of security in the form of a ground lease (see Section 3.03 of the Operating Agreement). Moreover, the Navy has conveyed in fee all the improvements and easements on the properties in question to the private developer. This means that, in effect, the DON entered into a ground lease with the LLC, and conveyed the DON's right, title, and interest in the existing improvements, easements and appurtenances to the LLC through a leasehold mortgage deed and security agreement dated November 1, 2004.

As mentioned above, the approximate value of this conveyance in fee in November 2004 for all housing units located in the Northeast Project was \$265 million. This conveyance by the Navy has already taken place, and no further financial liability may be imposed on the Navy. The DON's liability now is limited to the extent of its pledge of the ground lease, and it is not liable for any of the "obligations, debts or losses" of the LLC beyond that contribution. (See Section 3.08(a) of the Operating Agreement.) Thus, the DON's liability is limited to an amount that cannot exceed the fair market value of its pledged security (i.e., the ground lease).

With respect to the role of the private developer, it has also entered into several important financial transactions. The private developer, acting through the LLC, has issued unregistered taxable housing revenue First Tier bonds (2004-A Bonds) in the amount of

\$417 million with a credit rating of AA. Second Tier bonds (Series 2004-B Bonds) in the amount of \$100 million with a credit rating of A+ were also issued, and are subordinate to the First Tier bonds. These bonds were issued pursuant to a trust debenture agreement with JP Morgan Trust as the bond trustee. As a credit enhancement, the American International Group (AIG) has agreed to provide the LLC (and the bond trustee) with a Credit Facility sufficient to make timely principal and interest payments to the bond holders should the LLC fail to make such payments due to certain conditions or events. Please note that these bonds along with any business or financial obligations of the LLC are NOT guaranteed by the DoD, or by the DON as an agency of DoD, under the full faith and credit clause of the US. Constitution.

The bonds are debt obligations of the LLC payable from and secured by the LLC's revenues and security pledged under the bond Trust Indenture and Security Agreement. The principal and interest on the bonds are primarily payable from the revenues and receipts received from military personnel living in privatized units who expend their BAH to live in the units. This income stream, after paying operating costs, finances principal and interest payments on the bonds issued by the LLC.

The private developer has invested \$10.6 million in equity, and raised the balance of the \$617 million needed to complete the housing projects. According to the Navy, about \$400 million (or 69%) of the budgeted funds set aside by the bond trustee, remain available for the Project. This means that over \$200 million has already been used to pay certified construction and closing costs (requisitioned to date) as well as to capitalize reserve funds. Based on a pro forma financial statement provided potential investors in the final offering memorandum, the LLC or the bond underwriter have calculated the following additional financial metrics for the project:

- Total Average Annual Debt Service (AADS) is approximately \$33 million.
- Potential Gross Income = \$87 million*
- Effective Gross Income = \$72 million*
- Operating Expenses = \$26 million*
- Net Operating Income (NOI) = \$46 million*
- Debt Service = \$36 million*
- Cash Flow Available = \$10 million*
- Debt Service Coverage Ratio (DSCR) = 1.31

* (After project stabilization in 2011)

In the event that the closures of the three Navy facilities, New London, Brunswick, and Portsmouth takes place, this would represent about 64% (or 2,729 units) of the net units promised by the LLC. Assuming these three installations also represent about 64% of the project's net operating income and 64% of total project debt service, the financial impact of these pro rata reductions would be expected to be nominal. (These are assumptions however, and actual percentages may vary.) However, if these locations and units represent a higher proportion of capital costs and gross income, one could expect the

financial impact to be greater, potentially affecting project's financial feasibility and performance.

If the DON withdraws from the LLC as a member by terminating its partnership interest in it, this may mean that the outstanding bonds may need to be prepaid prior to their maturity date in 2049. The capital contained in the Project fund (approximately \$400 million) may be used for this purpose, less other costs including interest. The Optional Redemption clause of the Final Limited Offering Memorandum apparently may be exercised by the developer in this case. If there is a shortfall, then the bond trustee could use the credit facility provided by AIG to cover any payment shortfalls.

The DON may also have the option of "selling" the underlying realty supporting the three properties affected by BRAC closures to the LLC. If this option were exercised by the Navy, it would effectively privatize all the housing developed by the LLC at the three installations in question into 100% privatized commercial property. This means that the Navy would seek fair market value (FMV) in exchange for selling its fee interest in the realty supporting New London, Brunswick and Portsmouth properties to the private developer.

If land values have decreased since November 2004, or plummet due to the base closings, this may mean that the value of the Navy's in-kind contribution to the LLC would have decline proportionately. Effectively, the Navy's leasehold interest in the LLC (that has been pledged as security under the mortgage) may be at some risk, and therefore the Navy could find itself in the position of not being able to fully redeem its investment in the LLC. Alternatively, if land prices increase, the Navy may find itself in the position of profiting from the sale. However, it is not clear whether the Navy will give this option serious consideration as the question is moot at this time, and other financial alternatives are available to it.

STAFF CONCLUSION:

In a nutshell, it is unlikely, in the view of the Commission staff, that the Navy will incur an unfunded contingent liability (or incur a substantial one-time termination cost in COBRA) if the Navy's membership in the LLC is terminated due to BRAC closures. The one-time conveyance in fee of the housing units, valued at approximately \$265 million, has already taken place, and the Navy does not incur further financial liability for the repayment of the debts or losses of the LLC, even if its partnership interest in the LLC terminates due to BRAC closures, or other reasons.

Further, with respect to the pledged security of the 50-year ground lease for the eight properties in the Northeast Project, respectively, it is probable that the Navy will seek the FMV for this leasehold interest or sell the property outright as a negotiated term of its withdrawal from the LLC. The FMV of this interest may actually be a profit, rather than a loss, to the Navy in the final analysis.

The Offering Memorandum, the Leasehold Agreement and the Trust Indenture may be made available to you at your request. However, as these documents were made available to BRAC staff members for the sole purpose of completing this analysis, these documents have been restricted by the Navy from disclosure under FOIA laws. Accordingly, these documents have not been entered into the public record of the BRAC Commission at this time.



McDaniel, Brian, CIV, WSO-BRAC

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 4:16 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Rumu,

First some additional facts for consideration:

New London, Brunswick, and Portsmouth would have 64% of the total privatized units.

Development or Total uses = \$617M, of which \$517M (84%) is being borrowed by the Company and another is covered by the MM's \$10.6M (2%) equity contribution. The Remaining \$89.4M (14%) will be pro forma reinvestment income from bond proceeds.

Of the \$617M, approx.:

\$557.7M or 83% will be used to demo, rehab, or build new houses.
\$ 23.6M will be set aside for project contingency needs, if they materialize during construction \$ 20.5M for reserve accounts for the life/maturity of the bonds (amort period is 44 years) \$ 14.6M for closing soft costs (which should have already been paid out by bond trustee at bond closing last November)

Bond amortization period is 44 years
Average Annual Debt Service (AADS) is approximately \$33M American International Insurance is technically providing the LLC with a Credit Facility - versus bond insurance policy - equal to AADS or about \$33M.

Issuer disclosed stabilized (2011) annual pro forma:

Potential Gross Income of \$87.4M
Effective Gross Income of \$71.8M
Operating Expenses of \$26.3M
Net Operating Income (NOI) of \$45.5M
Debt Service of \$34.6M
Debt Service Coverage Ratio (DSCR) of 1.31 Cash Flow Available (after Reserves and Replacement) of \$9.8

I'll come down to your office.

-----Original Message-----

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 1:40 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: RE: New London

As we discussed, here's a short paragraph re: privatized Navy housing for the Northeast Project for a short briefing of the Chairman later today, depending on his availability, interest, etc. Please let me know if there are any misstatements as you are ahead of me in terms of doc. review. Thanks, Rumu

The Military Housing Privatization Initiative (MHPI) is a public/private partnership whereby private sector developers may own, operate, maintain, improve and assume responsibility for military family housing under circumstances where national security is not adversely affected. The MHPI was enacted on February 10, 1996, as part of the National Defense Authorization Act for fiscal year 1996, and these authorities were made permanent by Congress in 2004. Under the MHPI authorities, the Department of Defense (DoD) can work with the private sector to revitalize and create military family housing by using a financial "toolbox" -- including direct loans, loan guarantees, equity investments, and conveying or leasing military property or facilities. The National Defense Authorization Act for Fiscal Year 2005, Public Law 108-375 107, Section 2805, provided permanent authorities to the Military Housing Privatization Initiative.

Rumor -

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Does this pkg bring
together key items on
the housing issue?

R.

INFORMATION MEMORANDUM ON THE NAVY'S PRIVATIZED HOUSING
(NORTHEAST PROJECT)

DATE: August 2, 2005

FROM: Office of the General Counsel; R&A (Navy Team)

Overview: The Military Housing Privatization Initiative (MHPI) is a public-private partnership whereby private sector developers may own, operate, maintain, improve and assume responsibility for military family housing under circumstances where national security is not adversely affected.

The MHPI was enacted on February 10, 1996, as part of the National Defense Authorization Act for fiscal year 1996, and these authorities were made permanent by Congress in 2004. Under the MHPI authorities, the Department of Defense (DoD) can work with the private sector to revitalize and create military family housing by using a financial "toolbox" -- including direct loans, loan guarantees, equity investments, and conveying or leasing military property or facilities. The National Defense Authorization Act for Fiscal Year 2005, Public Law 108-375 107, Section 2805, provided permanent authorities to the Military Housing Privatization Initiative, as codified at 10 U.S.C. § 2871, *et seq.*

Since the MHPI was enacted in 1996, after the completion of the 1995 BRAC Round, the issue of privatized housing under that legislation was not raised during the course of any previous BRAC Commission. However, the Commission is aware that the 1995 BRAC Round did have a substantial number of staff files discussing privatized housing matters.

In essence, the MHPI, as amended, allows DoD to legally enter into or become a member of a non-governmental special or sole purpose (and bankruptcy remote) entity created exclusively for the purpose of financing, building, owning, operating, and maintaining rental housing for the benefit, on a priority occupancy basis, of military members and their families. These special purpose entities can take the form of a limited partnership into which DoD is authorized to provide appropriated funds (i.e., cash) or contribute other valuable assets including land and existing DoD owned family housing units in order to enhanced the partnership's ability to attract and borrow the substantial amount of private funds needed to rehabilitate and/or build new housing on government land.

These "partnerships" -- as organized in acceptable legal structures including Limited Liability Corporations (LLCs) -- are created as legal entities by a competitively-selected private housing developer, and are legally separate from the Department. In other words, DoD incurs limited legal liability as a result of its membership in such partnerships thereby permitting DoD to comply with existing federal laws and budget scoring restrictions. At the same time, this frees the Department from the burden of having to budget and expend limited capital and operating funds on the construction, operation and maintenance of DoD-owned family housing units. Further, since the individual military services have agreed to enter into these public-private ventures as limited liability

members, the member Services and the DoD are legally shielded from the entity's legal, business, and financial obligations. In fact, although DoD retains some approval rights affecting the quality and management of the housing, the Department does not participate in the daily management and operation of such partnerships.

Although no minimum cash contribution has been set for any DoD investment in a project, there is a maximum cash contribution. DoD may invest a maximum of 33.5% of the capital cost of a project. Since all sites and projects differ, and because the services each prioritize their own projects, the full 33.5% cash contribution may not be needed in each project. However, DoD also has the authority to convey land or buildings as all or part of its investment. If it chooses this route, it may not exceed 45% of the total capital cost if land or facilities are conveyed. For projects involving renovation, replacement, and support facilities, DoD's total equity contribution may not exceed 45% of a project's capital cost.

Navy Northeast Project: In early 2004, the Department of the Navy (DON) awarded a family housing privatization project with a total development cost of \$617.8 million for the privatization of 4,264 net units at installations managed by Navy Region Northeast. As part of the transaction, the developer and the DON formed a Limited Liability Corporation (LLC) to borrow funds in addition to the cash or in-kind contributions made by the developer and the DON, so that the LLC would have, or would be able to secure, all the money needed to execute its development plan as well as manage and maintain the privately-owned rental housing on government land leased by the Navy to the developer. In return for the government lease, the developer has promised to develop, or caused to be developed, market rental housing for use by military member and their families at the following Navy installations:

- NSB New London, Croton, CT (1,796 units)
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- NAES Lakehurst, Lakehurst, NJ (114)
- Mitchell Manor, Long Island, NY (250 units)
- NS Newport, Newport, RI (869 units)
- NSU Saratoga Springs, Saratoga Springs, NY (200 units).

By November 2004, the Navy had entered into a 50-year land lease, conveyed ownership of existing houses, and became a member of the Navy Northeast LLC. Concomitant with lease execution, the LLC borrowed the balance of the money it needed to begin design and construction activities at the various locations. After the developer completes the housing projects, it has agreed to lease the units, on a priority basis, to Navy members assigned to the various activities. Members, in turn, can select to rent housing from the LLC using their basic allowance for housing (BAH) to cover all, or a substantial portion, of the rent.

Out of the LLCs total project development budget of \$617 million, the LLC borrowed \$517 million (84% of the total budget) by issuing and selling unregistered taxable revenue bonds (i.e., private placement) to private institutional investors. The LLC will use the all borrowed funds along with its upfront cash contribution of \$10.6 million (2% of the total budget), plus another \$89.4 million (14% of the total budget) generated by either reinvestment income of bond proceeds or annual residual cash flows (on a pro forma basis), to complete the housing net units planned for each of the eight sites, namely, Brunswick, Earle, Fairfield, Lakehurst, Mitchell, New London, Newport, Portsmouth, and Saratoga Springs.

Of the \$617 million project budget, the LLC plans on using \$581 million, or 94% of the project budget to cover design and construction costs including contingencies; \$15 million to fund investor-required project and investments reserves, and about \$6 million for housing transition costs. The balance of the funds, or about \$15 million, was used to pay the LLC's closing and legal costs.

Since the DoD recommendations involve complete closures of NSB New London and NSY Portsmouth, and substantial realignment or closure of NAS Brunswick, the issue of whether these potential closures may in fact create an unfunded contingent liability that DoD should have added as an additional cost in COBRA is being explored by BRAC staff. The DON has responded to BRAC Commission questions through the clearinghouse, and those responses have been taken into account (and entered into the public record) by the BRAC staff.

Northeast Project Transaction Structure: The DON entered into a limited liability corporation, the GMH Military Housing -- Navy Northeast LLC, a Delaware corporation, as a member. (The DON has also agreed, as set forth in Section 8.17 of the Operating Agreement of the Northeast Housing LLC, that the GMH Communities Trust will make an initial public offering (IPO) of securities, and will succeed to the GMH Military Housing, LLC in due course.)

The private investor ("developer") is the managing member of the LLC. The DON pledged a 50-year leasehold interest in the property used to secure the Northeast Project in an amount of \$26 million as pledged security. This is not a cash or equity investment, but simply a pledge of security in the form of a ground lease (see Section 3.03 of the Operating Agreement) whereby the improvements and easements on the property in question are conveyed in fee to the private developer. In effect, the DON entered into a ground lease with the LLC, and conveyed the DON's right, title, and interest in the land, improvements, easements and appurtenances to the LLC through a leasehold mortgage deed and security agreement dated November 1, 2004.

The DON's liability is limited to the extent of its pledge of the ground lease, and it will not be liable for any of the "obligations, debts or losses" of the LLC beyond that contribution. (See Section 3.08(a) of the Operating Agreement.) Thus, the DON's liability is limited to an amount that cannot exceed the fair market value of its pledged

security (i.e., the ground lease) or, in other words, an amount of not more than \$26 million. (The actual liability, if any, may be far less.)

The private developer, acting through the LLC, has issued unregistered taxable housing revenue First Tier bonds (2004-A Bonds) in the amount of \$417 million with a credit rating of AA. Second Tier bonds (Series 2004-B Bonds) in the amount of \$100 million with a credit rating of A+ were also issued, and are subordinate to the First Tier bonds. These bonds were issued pursuant to a trust debenture agreement with JP Morgan Trust as the bond trustee. As a credit enhancement, the American International Group (AIG) has agreed to provide the LLC (and the bond trustee) with a Credit Facility sufficient to make timely principal and interest payments to the bond holders should the LLC fail to make such payments due to certain conditions or events. Please note that these bonds along with any business or financial obligations of the LLC are NOT guaranteed by the DoD, or by the DON as an agency of DoD, under the full faith and credit clause of the US. Constitution.

The bonds are debt obligations of the LLC payable from and secured by the LLC's revenues and security pledged under the bond Trust Indenture and Security Agreement. The principal and interest on the bonds are primarily payable from the revenues and receipts received from military personnel living in privatized units who expend their BAH to live in the units. This income stream, after paying operating costs, finances principal and interest payments on the bonds issued by the LLC.

The private developer has invested \$10.6 million in equity, and raised the balance of the \$617 million needed to complete the housing projects. According to the Navy, about \$400 million (or 69%) of the budgeted funds set aside by the bond trustee, remain available for the Project. This means that over \$200 million has already been used to pay certified construction and closing costs (requisitioned to date) as well as to capitalize reserve funds. Based on a pro forma financial statement provided potential investors in the final offering memorandum, the LLC or the bond underwriter have calculated the following additional financial metrics for the project:

- Total Average Annual Debt Service (AADS) is approximately \$33 million.
- Potential Gross Income = \$87 million*
- Effective Gross Income = \$72 million*
- Operating Expenses = \$26 million*
- Net Operating Income (NOI) = \$46 million*
- Debt Service = \$36 million*
- Cash Flow Available = \$10 million*
- Debt Service Coverage Ratio (DSCR) = 1.31

* (After project stabilization in 2011)

In the event that the closures of the three Navy facilities, New London, Brunswick, and Portsmouth takes place, this would represent about 64% (or 2,729 units) of the net units

promised by the LLC. Assuming these three installations also represent about 64% of the project's net operating income and 64% of total project debt service, the financial impact of these pro rata reductions would be predicted to be nominal. (These are assumptions however, and actual percentages may vary.) However, if these locations and units represent a higher proportion of capital costs and gross income, one could expect the financial impact to be greater, potentially affecting project's financial feasibility and performance.

Based on staff and legal reviews, it appears DON will have the option, as far as we are aware, of "selling" the affected properties to the LLC and in so doing effectively privatize all the housing developed by the LLC at the three installations into 100% privatized commercial property. This means that the Navy would seek fair market value (FMV) in exchange for selling its fee interest to the managing member of the LLC. If land values have decreased since last November, or plummet due to the base closing, this may mean that the value of the Navy's in-kind contribution to the LLC would have decline proportionately. Effectively, that portion of the Navy's \$26 million leasehold equity position in the LLC (and pledged as security under the mortgage) may be at some risk, and therefore the Navy could find itself in the position of not being able to fully redeem its investment in the LLC. Alternatively, if land prices increase, the Navy may find itself in the position of profiting from the sale.

Alternatively, if the Navy no longer has statutory authority to continue as a member of the LLC vis-à-vis the closed facilities, the DON may be required to withdraw from the LLC as a member. If this occurs, this may mean that the bonds may need to be prepaid prior to their maturity date in 2049. The capital contained in the Project fund (approximately \$400 million) may be used for this purpose, less other costs including interest. The Optional Redemption clause of the Final Limited Offering Memorandum apparently may be exercised by the developer in this case. If there is a shortfall, then the bond trustee could use the credit facility provided by AIG to cover any payment shortfalls.

Staff Conclusion:

In a nutshell, it is unlikely, in the view of the Commission staff, that the Navy will incur an unfunded contingent liability (or incur a substantial one-time termination cost in COBRA) as a result of the bond offerings made pursuant to the Northeast project, even if the Navy's membership in the LLC is terminated due to BRAC closures since the scope of the DON's liability is apparently limited to its security pledge of \$26 million.

The Offering Memorandum, the Leasehold Agreement and the Trust Indenture may be made available to you at your request. However, as these documents were made available to BRAC staff members for the sole purpose of completing this analysis, these documents have been restricted by the Navy from disclosure under FOIA laws. Accordingly, these documents have not been entered into the public record of the BRAC Commission at this time.

Hague, David, CIV, WSO-BRAC

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Tuesday, July 12, 2005 3:43 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Cc: Hague, David, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC
Subject: RE: Criterion 8 Environmental Impact -- Request for Legal Guidance

Brian: Sorry for the long wait, but I have also prepared a supporting legal memo that took a while to research, and I will provide it to you soonest. To answer the questions you pose below, first note the following:

1. The BRAC law sets forth the selection criteria to be used by the Secretary of Defense in making recommendations for closure or realignment of military installations located within the United States and its territories. Section 2913(c)(4) sets forth "other criteria" to be used by the Secretary, specifically:

The environmental impact, including the impact of costs related to potential environmental restoration, waste management, and environmental compliance activities.

While Section 2913(d) makes it clear that the Secretary shall "give priority consideration to the military value criteria" specified in Section 2913(b), this does not mean that the environmental impact, as a criterion, may be disregarded or ignored in making calculations in support of the Secretary's final recommendations for closures or realignments.

If the R&A staff, in reviewing the justification data submitted by DoD in support of its recommendations has determined that this data does not adequately address, calibrate or factor in environmental impacts (including the costs associated with restoration, management and compliance), then there may be grounds to assert that the Secretary has "substantially deviated" from the selection criteria pursuant to Section 2903(d)(B), thus, providing legal grounds for the Commission to propose changes to the Secretary's recommendations.

2. As far as funding for environmental remediation is concerned, in a nutshell, DoD is fully responsible for paying for all present and future environmental remediation costs. In 1996, the U.S. Congress, in a national defense authorization bill enacted in September 1996 (National Defense Authorization Act for Fiscal Year 1997, Pub. L. No. 104-201, § 322(a)(1), 110 Stat. 2422, 2477 (1996)), established several environmental restoration accounts for the DOD budget. 10 U.S.C. § 2703(a) (2000) establishes separate accounts for the DOD in general, the U.S. Army, the U.S. Navy, and the U.S. Air Force. See 10 U.S.C. § 2703(a)(1)-(4)).

In particular, the U.S. Congress established a separate environmental restoration account for Formerly Used Defense Sites (FUDS). (10 U.S.C. § 2703(a)(5) (2000)). I have been advised that these accounts are replenished with appropriated funds by Congress each fiscal year for each service. Thus, DoD does not make use of other appropriations available to the Environmental Protection Agency (EPA), for example, for brown fields cleanup, nor does it have a need to do so.

If other related issues come up in relation to environmental remediation, please let me know and I'll try to help out, Rumu

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18 Arlington, VA 22202-3920
Tel: (703) 699-2973
Cell: (703) 901-7843
Fax: (703) 699-2975

-----Original Message-----

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Monday, June 27, 2005 11:53 AM
To: Sarkar, Rumu, CIV, WSO-BRAC

Cc: Hague, David, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC
Subject: Criterion 8 Environmental Impact -- Request for Legal Guidance

Rumu,

In regard to Navy Team's due diligence analysis of Criterion 8, are you aware of any legal (or policy) guidance which permitted DoD to discount consideration of "the impact of costs related to potential environmental restoration ." when capturing and analyzing data related to Criterion No. 8?

On a related subject pertaining to what budget resources are available to DoD to pay for the costs of environmental restoration (i.e., 2005 BRAC funds or other "DoD funds authorized/appropriated environmental management, investigation, and clean-up) at "closing" installations, can you tell me the status, and potential affect if passed, of legislative language (found I believe in the Senate's version of the FY 2006 DoD Authorization Bill) which appears to prohibit DoD from using any other source of funding -- other than BRAC funds -- to clean-up/restore sites on property closed due to 2005 BRAC?

This "question" has come up during some base and community visits (and amongst analysts), and we in the Navy Team would like to understand how the BRAC law, as amended (or case law) generally addresses the general question of "environmental" impact", and specifically the question of whether or not DoD may have deviated (perhaps substantially) by excluding the impact of "...cost related to potential environmental restoration ." during its deliberations.

As always, we are available to discuss these questions further if you believe a meeting may be more beneficial. Enhancing our ability to understand the meaning/intent of criterion #8 as well as its relative weight compared to the other 7 criteria, will not only allow the "analysts" to target our analytical efforts more precisely, but also give us the information we need to effectively respond to congressional and community representatives when they raise this "hot button" (and potentially expensive) issue.

Thank you,
Brian

This memorandum will summarize salient provisions of law, and Department of Defense (DoD) practice, with regard to environmental remediation on BRAC sites. Further information may be sourced from the Office of the General Counsel, as needed.

A. Use of Environmental Impact as a Criterion for Making BRAC Recommendations. Section 2913 of the Defense Base Closure and Realignment Act of 1990 (Public Law 101-510), codified at 10 U.S.C. § 2687 note, as amended by Fiscal Year 2002 Department of Defense Authorization Act (Public Law 107-107) (the "BRAC law"), sets forth the selection criteria to be used by the Secretary of Defense (the "Secretary") in making recommendations for closure or realignment of military installations located within the United States and its territories. Section 2913(c)(4) of the BRAC law sets forth "other criteria" to be used by the Secretary, specifically:

The environmental impact, including the impact of costs related to potential environmental restoration, waste management, and environmental compliance activities.

While Section 2913(d) makes it clear that the Secretary shall "give priority consideration to the military value criteria" specified in Section 2913(b), this does not mean that the environmental impact may be disregarded or ignored in making calculations in support of the Secretary's final recommendations for closures or realignments.

If the R&A staff, in reviewing the justification data submitted by DoD in support of its recommendations determines that this data does not adequately address or factor in the environmental impacts (including the costs associated with environmental restoration, management and compliance), then there may be grounds to assert that the Secretary has "substantially deviated" from the selection criteria pursuant to Section 2903(d)(B), thus, providing legal grounds for the Commission to propose changes to the Secretary's recommendations.

B. Funding for Environmental Remediation. In a nutshell, DoD is fully responsible for paying for all present and future environmental remediation costs. The U.S. Congress, in a national defense authorization bill enacted in September 1996 (National Defense Authorization Act for Fiscal Year 1997, Pub. L. No. 104-201, § 322(a)(1), 110 Stat. 2422, 2477 (1996)), established several environmental restoration accounts for the DOD budget. Specifically, a statute codified at 10 U.S.C. § 2703(a) (2000), establishes separate accounts for the DOD in general, the U.S. Army, the U.S. Navy, and the U.S. Air Force. *Id.* § 2703(a)(1)-(4)).

Department of the
In particular, the U.S. Congress established a separate environmental restoration account for Formerly Used Defense Sites (FUDS). (See 10 U.S.C. § 2703(a)(5) (2000)). I have been advised that these accounts are replenished with appropriated

military department
funds by Congress each fiscal year for each ~~service~~. Thus, DoD does not make use of other appropriations available to the Environmental Protection Agency (EPA), for example, for brown fields cleanup, nor does it have a need to do so.

explain what these are
The remainder of this memorandum gives a general overview of the salient laws that pertain to BRAC site-related environmental remediation and other issues.

C. Legal Overview of Environmental Remediation Concerns.

- CERCLA (Superfund). In 1986, the U.S. Congress reauthorized and amended the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA). (*See Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613; Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub. L. No. 96-510, 94 Stat. 2767 (codified, as amended, in various sections of 26 and 42 U.S.C.)*).

AP CERCLA, or Superfund, was reauthorized by the Superfund Amendments and Reauthorization Act of 1986 (SARA)(Pub. L. No. 99-499, 100 Stat. 1613 (codified, as amended, in various sections of 10, 26, and 42 U.S.C.). SARA also established the Defense Environmental Restoration Program (DERP) pursuant to 10 U.S.C. § 2701(a)(1) (2000).

Under Superfund rules, a release or threatened release of a hazardous substance can be mitigated through a removal or a remediation. Whereas a removal involves the short-term removal of the hazardous substance, a remediation involves a long-term environmental restoration. Section 2905(e) of the BRAC law also provides the Secretary with transfer authority, subject to § 120(h) of CERCLA, to transfer by deed any real property or facilities to any person that agrees to perform all necessary environmental restoration. *or entity*

- Defense Environmental Restoration Program (DERP). The DERP requires the ~~DoD~~ to undertake the environmental restoration of installations and facilities under its jurisdiction. Under § 120 of CERCLA, 42 U.S.C. § 9620, the program is subject to the requirements of Superfund. The DERP is carried out in consultation with the U.S. Environmental Protection Agency (EPA), pursuant to 10 U.S.C. § 2701(a)(3), but DoD is the lead department for environmental cleanup under the DERP. Essentially, the goal of the DERP is to reduce, in a cost-effective manner, the risks to human health and the environment attributable to contamination from ~~DoD~~ activities.

Under DERP, DoD is responsible for the environmental restoration, in accordance with the requirements of CERCLA, 42 U.S.C. § 9620(a), of active facilities and sites that are under DoD jurisdiction, and inactive facilities and sites that were under DoD jurisdiction prior to the enactment of SARA. (*See* 10 U.S.C.

§ 2701(c)(1)(A)-(B) (2000)).

DERP authorizes DoD to contract for services from other federal agencies, state and local government agencies, and non-profit conservation organizations to assist with environmental restoration. (10 U.S.C. § 2701(d)(1) (Supp. II 2002)). In addition, § 120 of CERCLA authorizes DoD to contract for services from the EPA for environmental restoration. (See 42 U.S.C. § 9620(e)(2)(2000)).

Further, under DERP, DoD advises affected state and local authorities of proposed environmental restoration, and permits the authorities to provide comments. (See 10 U.S.C. § 2705(a)-(b)). DERP also requires DoD to submit annual reports to the U.S. Congress on defense environmental restoration activities under 10 U.S.C. § 2706(a)(2000).

- Base Closure Redevelopment and Homeless Assistance Act. In addition, as of November 1993, DoD is required by law to make closed installations available to state and local redevelopment authorities. (See National Defense Authorization Act for Fiscal Year 1994, Pub. L. No. 103-160, 107 Stat. 1547(1993); see also § 2905(b) (4), *et seq.* of the BRAC law.) This effort was undertaken in furtherance of economic revitalization of communities affected by base closures, and for assistance with the homeless. The Base Closure Redevelopment and Homeless Assistance Act of 1994, 10 U.S.C. § 2687 note (200), advanced those goals. (See also § 2905 (b) (6)(F) of the BRAC law.)

In September 1996, a national defense authorization bill also amended the BRAC law to authorize the conveyance of closed installations to state and local redevelopment authorities prior to completion of environmental restoration. (See National Defense Authorization Act for Fiscal Year 1997, Pub. L. No. 104-201, 110 Stat. 2422 (1996) § 334(a), 110 Stat. at 2486; see also 42 U.S.C. § 9620(h)(3)(C) (2000) (providing for early transfer authority under CERCLA)).

- National Priorities List. Not all releases or threatened releases of a hazardous substance are entitled to remediation under CERCLA. Most are entitled just to removal under Section 105 of CERCLA, a section that also requires a list of national priorities for environmental restoration -- the so-called National Priorities List (NPL). (See 42 U.S.C. § 9605(a)(8)(B)).

For the 2005 BRAC list proposed by DoD, 65 installations are on the NPL. All BRAC installations in need of environmental restoration are eligible for long-term environmental remediation regardless of NPL status. (In general, however, the EPA does not assist with the environmental restoration of BRAC installations not on the NPL.)

- NEPA. Section 2905(c) of the BRAC law specifically exempts the President, DoD and the Commission from the provisions of the National Environmental Policy Act (NEPA) of 1969 (42 U.S.C. § 4321, *et seq.*), except insofar as DoD will be required to apply NEPA to the process of property disposal during the closure and/or realignment process. *Id.* at § 2905(c)(2)(A)).

There are other complex environmental issues that may be relevant to the 2005 BRAC process, and the foregoing discussion is simply meant to highlight the most important laws controlling the environmental remediation process. Please consult with the Office of the General Counsel further, as necessary.

Sources:

James W. Moeller, "ARSENIC AND AN OLD BASE: LEGAL ISSUES ASSOCIATED WITH THE ENVIRONMENTAL RESTORATION OF DEFENSE SITES IN WASHINGTON, D.C., USED FOR THE DEVELOPMENT AND DISPOSAL OF WORLD WAR I CHEMICAL MUNITIONS," 54 *Cath. U.L. Rev.* 879 (2005).

**DOD Response the Base Closure & Realignment Commission Questions
(Control Number-BAM#3-17-CO-553)**

3. Explain the legal structures or types of agreements (e.g., ground leases, Limited Liability Corporations (LLC), financial guarantees, etc.) typically used by the Military Services to facilitate housing privatization projects? *DoD Response: The two main deal structures are (1) a combination of a long-term ground lease and a government direct loan, and (2) a combination of a long-term ground lease and a limited partnership or a limited liability company. In six lease or lease/debt deals, the government also has provided a limited loan guarantee against circumstances where the private loan falls into default due directly to the government's reduction of military tenants. The guarantee requires developer best efforts and none of the existing guarantees appear to be at risk of being exercised by the private lender.*
4. Identify and provide a brief description (installation, location, number of units new or rehabbed, type of agreement, type and amount of private financing, etc.) for each of the Housing Privatization Projects affected by DoD BRAC recommendations. Identify whether the related BRAC recommendation is to close or realign an activity? Provide an estimate of the financial cost to DoD to terminate a privatization agreement for each affected installation individually. *DoD Response: Aside from Navy Northeast (Navy Submarine Base New London, Connecticut is one installation included in this privatization deal called Navy Northeast Region), none of the BRAC recommendations appear to have an effect upon an executed housing privatization project.*
5. Legally, how much control do the Military Services have over the actions or decisions of the LLC? *DoD Response: The services as limited partners must concur with major decisions of the LP/LLC.*
6. Explain the legal and financial responsibilities and obligations, if any, assumed by the US Government when a Military Service agrees to become a member of a special purpose entity (like a LLC)? *DoD Response: As in any limited partnership or limited liability company, the services liability is limited to their financial contributions.*
7. By the nature of the Military Service's relationship to the LLC, does the government's "risk profile" change (i.e., worsen or increase) if the LLC (created by the private "partner") is established primarily to secure and borrow the funds – from sources of conventional real estate debt or public and private bond (debt) markets – needed to capitalize the housing project? *DoD Response: The service's liability is limited regardless of the private capital source to its financial contribution.*
8. Which entity in transactions employing a LLC assumes business or legal risks including construction risk, payment risk (due to DoD actions resulting in reductions or elimination of BAH) to mortgagees/lenders or other obligees, federal appropriations risk, termination for default, and termination for convenience (for the sole benefit of the government). *DoD Response: The risk is fully on the limited partnership or the limited liability company.*
9. As the result of the Military Services entering into or joining a LLC (or other housing privatization agreement), has the Office of Management and Budget (OMB) ever required a Military Services/DoD to set-aside existing or future budget resources (i.e., either appropriations or budget authority) sufficient to fund what it has interpreted to

be the creation of an “unfunded contingent liability” (under federal fiscal law), or a violation of budget scorekeeping rules for capital assets under OMB Circular A-11 (Appendices A and B)? *DoD Response: No, because the projects are designed to place the risk fully on the developer, which in lease/partnership deals is the limited partnership or the limited liability company.*

10. Which entity (e.g., the LLC?) is the borrower (or mortgagor) of record in a housing privatization project? *DoD Response: The partnership itself is the mortgagor.*
11. If the developer, borrower, or LLC does not provide the lender a direct financial guarantee, have lenders or investors required the LLC to provide alternative credit enhancements such as a Letter of Credit, bond insurance, or other form of third party payment guarantee? If so, what of guarantee was used in the Navy Northeast Family Housing Privatization Project and resulting Navy Northeast LLC. *DoD Response: No. In Navy deals, neither the developer, the borrower, nor the LLC provides the lender a direct financial guarantee. Bond insurance is occasionally secured; however, in the case of Navy Northeast Family Housing Privatization Project no alternative forms of credit enhancement was used.*
12. Is the developer and/or manager partner of the LLC required to invest a minimum amount of equity to cover development costs or help secure cost-effective financing? *DoD Response: There has not been a set minimum, but developer equity has been required in almost every project, particularly those projects requiring a government cash subsidy.*
13. Based on DoD experience with these transactions and its participation in LLCs, do lenders seek answers from the government either directly or indirectly through the LLC as to the need or essentiality of the housing to the Service’s mission, credit worthiness of the “payor” or “obligor” to the debt, and local housing market dynamic and trends? *DoD Response: No, they do their own due diligence.*
14. Explain what business and legal benefits flow to the Military Services and the other partners or members of the LLC as the result of the Military Service agreeing to become a member of a “housing” LLC. *DoD Response: Liability is limited while lines of communication are formalized.*
15. Does a LLC “own” or have exclusive control over monetary or non-monetary (e.g., real estate interests) assets controlled by over the life of the LLC and/or government ground lease? Do lenders or investors typically require the LLC to pledge any or all of its monetary and non-monetary assets to secure borrowed funds? *DoD Response: Project finances are generally secured by the subject land and improvements.*
16. Based on DoD’s experience with, or membership in an LLC, are funds (regardless of source or use) borrowed by the LLC considered “recourse” or “non-recourse” debt to the LLC? *DoD Response: Capital sources are secured by the land and may be recourse to the developer, but the developer is usually a special purpose entity whose assets are limited to the project itself.*
17. Have the Military Services agreed to subordinate the government’s real estate interest (i.e., the government’s fee interest in the leased property) to the lender/investors interests or position? *DoD Response: No, the government’s future interest or fee is not subordinated.*

statements which fully comply with the State Uniform Commercial Code-Secured Transactions or by the taking of possession of appropriate collateral. The parties further agree that all necessary continuation statements may be executed by the Trustee in its own name and/or on behalf of the Issuer, and shall be filed within the time prescribed by the State Uniform Commercial Code-Secured Transactions, and the appropriate parties shall maintain possession of appropriate collateral in order to continue the security interests identified in this Section, to the end that the rights of the Owners and the Trustee in the Project and other collateral shall be fully preserved as against third-party creditors of, or purchasers for value in good faith from, the Issuer.

Section 15.10 Maintenance of Security Interests. Annually, within 30 days after the end of each Fiscal Year, and so long as the Bonds have not been discharged under this Indenture, the Issuer shall file with the Trustee a certificate describing, as of the last day of that preceding Fiscal Year, each item of tangible personal property not described in a previous similar certificate, which has been added to the Project, whether as a substitution, replacement, or addition, and whether or not, when added, it became real property, if the aggregate cost of such items in that preceding Fiscal Year exceeds \$25,000. In addition, if during that preceding Fiscal Year any such personal property was added to the Project, the Issuer shall furnish to the Trustee an opinion of Independent Counsel to the effect that all steps requisite to perfection of the security interests of the Trustee in and to such property have been duly taken. All such opinions shall specify the further refilings, renewals, delivery of possession, or other action required in order to continue perfection of such security interests for so long as any Bonds remain Outstanding. The Issuer shall execute all instruments, including financing statements, and shall deliver possession of all instruments or cash deemed necessary or advisable in the opinion of Independent Counsel or reasonably requested by the Trustee for perfection of and continuance of the perfection of the security interests as aforesaid. The Issuer and the Trustee shall execute all instruments, including financing statements, required of the Issuer in the opinion of such Independent Counsel, and the Issuer shall file all such instruments executed by the Issuer or the Trustee, or cause them to be filed, and the Issuer shall continue the security interests of all such instruments by appropriate refilings as required by the Trustee or such Independent Counsel, or cause them to be so continued, and shall maintain possession of all appropriate instruments until all Bonds have been discharged under this Indenture.

Section 15.11 Construction and Binding Effect. This Indenture constitutes the entire agreement of the parties and supersedes any prior agreements. This Indenture shall inure to the benefit of and shall be binding upon, the Issuer and its respective successors and assigns.

Section 15.12 Amounts Remaining in Funds. It is agreed by the parties hereto that any amounts remaining in the Bond Fund, or other funds provided for herein other than in the Project Recapitalization Fund, after payment in full of the Bonds (or provision for payment thereof having been made in accordance with the provisions of this Indenture), the fees, charges, and expenses of the Trustee and paying agents in accordance with this Indenture, and all amounts owing under the Bond Documents and all sums due and owing to the Issuer, shall belong to and be paid to the Issuer by the Trustee. Any amounts remaining in the Project Recapitalization Fund shall belong and be paid to the Navy by the Trustee.

Section 15.13 Fees and Expenses Paid by the Issuer. Except as set forth in Article XIV, the Issuer shall pay all fees and expenses relating to this Indenture, including but not limited to, the expense of examination of title, premiums of the Title Policy and all endorsements, costs of all supplemental examinations and certifications of title, the recording and filing fees and taxes upon any financial statement or upon the Mortgage and the assignment documents, expenses of any present or future assignment or assignments of collateral security, if any, required by the Trustee, and attorneys' fees and disbursements.

If a default or an Event of Default occurs and the Trustee should employ legal counsel or incur other expenses for the collection of sums due hereunder and under the other Bond Documents or the enforcement of the performance or observance of any agreement on the part of the Issuer contained in this Indenture or in the other Bond Documents, the Issuer agrees that it will, upon demand, pay to the Trustee the reasonable fees and disbursements of such counsel and such other reasonable expenses so incurred by the Trustee including the costs of litigation. If the Issuer fails to make any payments required in this Section, such item will continue as an obligation of the Issuer secured by the lien of this Indenture and the lien of the Mortgage until the same has been paid in full. The Issuer agrees to pay the same with interest thereon from the date such payment was due at the Default Rate, until paid in full.

Section 15.14 No Agency Relationships. Neither the Bondholders nor the Trustee assume the duties of the contractor or architect of any Construction Work or any Additions or Alterations and shall be under no obligation to construct or supervise the construction of any Construction Work or any Additions or Alterations or to make any inspections of the improvements related thereto, and it is further understood and agreed that any inspection by the Trustee or the Bondholders or their officers, directors, shareholders, agents, or employees of any Construction Work or any Additions or Alterations, whether paid for by the Issuer or its successors in title, is for the sole purpose of protecting the security of the Bondholders, and the Issuer shall not be entitled to claim any loss or damage against the Bondholders or the Trustee or their respective officers, directors, shareholders, agents, or employees for the failure of any Bondholder's or the Trustee's respective officers, directors, shareholders, agents, or employees to properly discharge their responsibilities to the Trustee or any Bondholder. The Trustee shall not have any duty to the Issuer in respect of any such matter.

Section 15.15 Conditional Assignments. The Issuer shall execute a conditional assignment directing the architect who has prepared any plans and specifications for any Construction Work or any Additions or Alterations to make available to the Trustee a complete set of the plans and specifications, which assignment shall be effective only in the event of a default hereunder by the Issuer. All construction contracts executed by the Issuer for construction of any Construction Work or any Additions or Alterations shall contain a provision that, or by separate agreement such contractors shall agree that, in the event of a default by the Issuer hereunder, said contracts with the contractors and/or sub-contractors shall be deemed assigned to the Trustee should the Trustee so desire and notify them in writing of same, in which case the Trustee shall be responsible for the carrying out of all the terms and conditions thereof in place of the Issuer in said contracts. The Issuer covenants to include such conditional assignments in all contracts and subcontracts executed for work to be performed on the Project. All construction and architectural contracts executed by the Issuer for construction of any Construction Work or any Additions or Alterations for the Project shall contain a provision allowing the Trustee to directly enforce such contractors' and architects' warranties under such contracts.

Section 15.16 Amendments, Changes, and Modifications. This Indenture may not be amended, changed, modified, altered, or terminated, except as provided in this Indenture and in each instance only with the prior written consent of the Trustee.

Section 15.17 Usury. Regardless of any provision contained in the Bond Documents, or any other documents or instruments executed in connection herewith, the Bondholders shall never be entitled to receive, collect, or apply, as interest hereon, any amount in excess of the highest lawful rate and in the event a Bondholder ever receives, collects, or applies, as interest, any such excess, such amount which would be excessive interest shall be deemed a partial prepayment of principal and treated hereunder as such; and, if the principal hereof is paid in full, any remaining excess shall be refunded to the Issuer. In determining whether or not the interest paid or payable, under any specific contingency, exceeds the highest lawful rate, the parties hereto shall, to the maximum extent permitted under applicable law, (i) characterize any non-principal payment as an expense, fee, or premium rather than as interest,

(ii) exclude voluntary prepayments and the effects thereof, and (iii) spread the total amount of interest throughout the entire contemplated term hereof; provided, however, that if the interest received for the actual period of existence hereof exceeds the highest lawful rate, the Trustee or the Bondholders shall either apply or refund to the Issuer the amount of such excess as herein provided, and in such event neither the Trustee nor any Bondholder shall be subject to any penalties provided by any laws for contracting for, charging, or receiving interest in excess of the highest lawful rate.

Section 15.18 Guaranty Payments. The payment of any amounts on behalf of the Issuer by the Guarantor pursuant to the Construction Guaranty or payment or performance of any obligations hereunder of the Issuer by the Guarantor under the Construction Guaranty shall be deemed the payment or performance by the Issuer and no Event of Default relating to such payment and performance shall occur if such actions by the Guarantor cure the occurrence that would otherwise constitute such Event of Default.

ARTICLE XVI ADDITION OF ADDITIONAL PROPERTY

Section 16.01 Addition of Additional Property. The Additional Property is to be subjected to the coverage of this Indenture, the Mortgage, the Property Management Agreement, the Asset Management Agreement, the Control and Sweep Agreement, and the other Transaction Documents so as to (i) comprise a portion of the Real Property, the Project, the Buildings and the Leased Premises, (ii) be the subject of the Plans and the Construction Work, and (iii) be otherwise the subject of and governed by the Transaction Documents. Upon satisfaction by the Issuer of the following conditions, and at the Issuer's sole cost and expense, the Additional Property shall be added to the coverage of this Indenture and the other Transaction Documents as referenced in the immediately preceding sentence:

(a) delivery to the Trustee and Owner Representative of an update of the Phase I Investigation, together with a reliance letter addressed to the Trustee and Owner Representative, all in form satisfactory to the Trustee and Owner Representative and evidencing no Hazardous Materials or Hazardous Substances other than as may be previously described in the Environmental Reports with respect to the Additional Property;

(b) delivery to the Trustee and Owner Representative of a certification by the Navy that, after inspection of the Additional Property occurring after completion of all construction in connection therewith, including without limitation, construction under the Pre-Delivery Contract (hereinafter defined), (i) there are no adverse changes in the Physical Condition Report (as defined in the Ground lease), (ii) the work required by the Order for Supplies and Services dated November 6, 2000 executed by The United States of America and SBBI, Inc. (the "Pre-Delivery Contract") has been finally and unconditionally accepted by the Navy, and (iii) the representations set forth in the Bond Documents, including without limitation, Section 8.2.5 of the Ground Lease, is true and correct with respect to the Additional Property

(c) delivery to the Trustee of the title insurance policy or policies or, if available under applicable law, an endorsement to the Title Policy delivered to the Trustee contemporaneously with the execution and delivery of this Indenture, pertaining to the Additional Property, with coverage amount acceptable to the Trustee and Owner Representative and with no exceptions thereto other than the Permitted Encumbrances and with an endorsement deleting all exceptions pertaining to and providing coverage with respect to mechanic's and materialmen's liens, supported by lien releases and waivers in form acceptable to the title insurer;

(d) delivery to the Trustee and Owner Representative of certificates of insurance evidencing that the Additional Property has been added to the coverage of the insurance policies then in place with

respect to the portions of the Real Property other than the Additional Property, with such insurance on the Additional Property otherwise complying with the insurance requirements set forth in this Indenture and in the Mortgage;

(e) inspection by Owner Representative of the Additional Property in the same manner as completed with respect to the Real Property other than the Additional Property prior to the date of this Indenture evidencing satisfactory condition to the same standard as such previously inspected Real Property;

(f) there shall be no unrepaired casualty damage on any portion of the Additional Property and no portion of the Additional Property shall be the subject of any pending or threatened condemnation or litigation;

(g) the forms of documents sufficient to amend the Transaction Documents (including, without limitation, the Ground Lease, the Mortgage, all applicable UCC financing statements, the Assignment of Leases, Rents and Security Deposits, the Property Management Agreement, the Asset Management Agreement, the Environmental Indemnification Agreement, the Assignment of Contracts, Permits and Approvals and the Completion Guaranty) have been approved by the Trustee and Owner Representative and have been executed by all parties thereto other than the Trustee;

(h) the Trustee and Owner Representative shall have received and approved such authority documentation and legal opinions as they may deem necessary or appropriate in connection with the amendments to the Transaction Documents described above;

(i) delivery to the Trustee and Owner Representative of satisfactory evidence that there is utility service available and in place through dedicated easements or other recorded documents and pursuant to written agreements to serve the Additional Property and the Real Property other than the Additional Property (1) in sufficient capacity after the addition of the Additional Property, and (2) at a cost consistent with previous estimates delivered to Owner Representative as of the date of this Indenture;

(j) delivery to the Trustee and Owner Representative of such other documents and materials pertaining to the Additional Property and the amendments to the Transaction Documents related thereto as the Trustee and/or Owner Representative may reasonably require to effectuate the purposes of this Article.

(Remainder of page intentionally left blank)



DEFENSE BASE CLOSURE AND REALIGNMENT COMMISSION
2521 SOUTH CLARK STREET, SUITE 600
ARLINGTON, VA 22202
TELEPHONE: 703-699-2950
FAX: 703-699-2735

July 13, 2005
BAM#3-17

Chairman:
The Honorable Anthony J. Principi

Commissioners:
The Honorable James H. Dickey
The Honorable Philip E. Cayle, III
Admiral Harold W. Gehman, Jr., USN (Ret.)
The Honorable James V. Hansen
General James T. Hill, USA (Ret.)
General Lloyd W. Newton, USAF (Ret.)
The Honorable Samuel K. Stinner
Brigadier General Sue Ellen Turner, USAF (Ret.)

Executive Director:
Charles Battaglia

Mr. Bob Meyer
Director
BRAC Clearinghouse
1401 Oak St.
Rosslyn VA 22209

Dear Mr. Meyer:

I respectfully request a written response from the Department of Defense concerning the enclosed document:

X *Base Closure & Realignment Commission question*

- 3. Explain the legal structures or types of agreements (e.g., ground leases, Limited Liability Corporations (LLC), financial guarantees, etc.) typically used by the Military Services to facilitate housing privatization projects?*
- 4. Identify and provide a brief description (installation, location, number of units new or rehabbed, type of agreement, type and amount of private financing, etc.) for each of the Housing Privatization Projects affected by a DoD BRAC recommendations. Identify whether the related BRAC recommendation is to close or realign an activity? Provide an estimate of the financial cost to DoD to terminate a privatization agreement for each affected installation individually.*
- 5. Legally, how much control do the Military Services have over the actions or decisions of the LLC?*
- 6. Explain the legal and financial responsibilities and obligations, if any, assumed by the US Government when a Military Service agrees to become a member of a special purpose entity (like a LLC)?*
- 7. By the nature of the Military Service's relationship to the LLC, does the government's "risk profile" change (i.e., worsen or increase) if the LLC (created by the private "partner") is established primarily to secure and borrow the funds -- from sources of conventional real estate debt or public and private bond (debt) markets -- needed to capitalize the housing project?*
- 8. Which entity in transactions employing a LLC assumes business or legal risks including construction risk, payment risk (due to DoD actions resulting in*

reductions or elimination of BAH) to mortgagees/lenders or other obligees, federal appropriations risk, termination for default, and termination for convenience (for the sole benefit of the government).

9. *As the result of the Military Services entering into or joining a LLC (or other housing privatization agreement), has the Office of Management and Budget (OMB) ever required a Military Services/DoD to set-aside existing or future budget resources (i.e., either appropriations or budget authority) sufficient to fund what it has interpreted to be the creation of an "unfunded contingent liability" (under federal fiscal law), or a violation of budget scorekeeping rules for capital assets under OMB Circular A-11 (Appendices A and B)?*
10. *Which entity (e.g., the LLC?) is the borrower (or mortgagor) of record in a housing privatization project?*
11. *If the developer, borrower, or LLC does not provide the lender a direct financial guarantee, have lenders or investors required the LLC to provide alternative credit enhancements such as a Letter of Credit, bond insurance, or other form of third party payment guarantee? If so, what of guarantee was used in the Navy Northeast Family Housing Privatization Project and resulting Navy Northeast LLC.*
12. *Is the developer and/or manager partner of the LLC required to invest a minimum amount of equity to cover development costs or help secure cost-effective financing?*
13. *Based on DoD experience with these transactions and its participation in LLCs, do lenders seek answers from the government either directly or indirectly through the LLC as to the need or essentiality of the housing to the Service's mission, credit worthiness of the "payor" or "obligor" to the debt, and local housing market dynamic and trends?*
14. *Explain what business and legal benefits flow to the Military Services and the other partners or members of the LLC as the result of the Military Service agreeing to become a member of a "housing" LLC.*
15. *Does a LLC "own" or have exclusive control over monetary or non-monetary (e.g., real estate interests) assets controlled by over the life of the LLC and/or government ground lease? Do lenders or investors typically require the LLC to pledge any or all of its monetary and non-monetary assets to secure borrowed funds?*
16. *Based on DoD's experience with, or membership in an LLC, are funds (regardless of source or use) borrowed by the LLC considered "recourse" or "non-recourse" debt to the LLC?*
17. *Have the Military Services agreed to subordinate the government's real estate interest (i.e., the government's fee interest in the leased property) to the lender/investors interests or position?*

I would appreciate your response by July 22, 2005. Please provide a control number for this request and do not hesitate to contact me if I can provide further information concerning this request.

Yours sincerely,

Frank Cirillo
Director
Review & Analysis



DEFENSE BASE CLOSURE AND REALIGNMENT COMMISSION
2521 SOUTH CLARK STREET, SUITE 600
ARLINGTON, VA 22202
TELEPHONE: 703-699-2950
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July 13, 2005
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Chairman:
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General Lloyd W. Houston, USAF (Ret.)
The Honorable Samuel N. Stinebaugh
Brigadier General Sue Ellen Turner, USAF (Ret.)

Executive Director:
Charles Battaglia

Mr. Bob Meyer
Director
BRAC Clearinghouse
1401 Oak St.
Rosslyn VA 22209

Dear Mr. Meyer:

I respectfully request a written response from the Department of Defense concerning the enclosed document:

X Base Closure & Realignment Commission question

- 18. In addition to the Military Service involved in these agreements, describe the types of private sector entities (e.g. real estate developers, lenders, bond investors, bond underwriters, bond insurers, credit enhancers) typically involved on the "private" or commercial side of these transactions as well as a brief description of their roles, responsibilities, and obligations.**
- 19. Do the private lenders/investors or their fiduciary agents or trustees have the right (or obligation) to cure material defaults (e.g. a non-payment default) or the contractual right to other remedies (beyond "cure" and foreclosure rights) designed to insure timely and adequate debt service payments?**
- 20. What is the average amount of project funds borrowed to develop a housing privatization project? What is the typical amortization period for privately borrowed funds? How much was borrowed by the Navy Northeast LLC?**
- 21. What is the current status or balance of the funds borrowed by the Navy Northeast LLC to build housing around Navy bases in New England? Does the Navy Northeast housing privatization agreement (e.g., the bond indenture) permit the LLC to use funds to build housing in support of the Navy's mission in another geographic region, like the southeast?**
- 22. In the case of Navy Northeast Family Housing Privatization Project, do the Navy's rights under the LLC agreement require it to concur in the managing partner's decision to use the borrowed funds to build housing elsewhere due to the potential closure of NSY Portsmouth or NSB New London and the realignment of NAS Brunswick?**

23. *Do lenders/investors require the LLC to borrow and set aside "reserve funds" (e.g., debt service reserves, operating reserves, maintenance reserves, etc.) to mitigate potential lender and/or investor risk?*
24. *Which party or member of the LLC bears 100% of the re-payment obligation for any project debt secured by the LLC? Under what circumstances, if any, might the government be exposed to re-payment risk due to its membership or relation to the LLC?*
25. *If not the LLC, is another party obligated to make repay project debt or bond holders if the developer becomes insolvent during the term of the ground lease or life of the LLC?*
26. *Please explain if potential closures of privatized housing projects (based on BRAC or otherwise) may result in the creation of unfunded contingent liabilities to pay termination costs to private developers and/or private investors."*
27. *Have prior BRAC closure recommendations and implementation actions required the Military Services to cancel or terminate housing privatization agreements including its participation in a LLC. If so, when and where?*
28. *In the case of Navy Northeast Family Housing Privatization Project, has the Navy agreed to provide utility, fire protection, and police services to privatized family housing and related facilities at NSY Portsmouth, NSB New London, or NAS Brunswick? What course of action is available to the Navy if the BRAC 2005 recommendation for these installations becomes law? If one possible course of action is for the Navy to make cash payments to the develop/asset manager in lieu of providing Navy services, please provide an estimate of this costs, and indicate whether or not this cost was factored into the COBRA cost benefits analyses associated with these recommendations?*
29. *If one of these housing privatization agreements is terminated due to implementation of a base realignment or closure decision, explain how the LLC (e.g., Navy Northeast LLC) shields the government from having to pay monetary damages or make debt service payments to the lender or bond holders if the rental housing project becomes nonperforming because its not "leased up" with enough military members or civilian tenants to cover the project's debt service?*
30. *Is DoD authorized to use or reprogram appropriated dollars used to make Basic Housing Allowance (BAH) payments to eligible military members to make payments to terminate a LLC and/or buyout the LLCs leasehold interest?*
31. *As part of the data gathering and scenario analysis, did DoD require the Services to obtain housing market assessments for installations slated for closure or significant gains in military population? If so, please provide copies of such assessments along with analysis and deliberative documents for NSY Portsmouth, NSB New London, and NAS Brunswick.*
32. *For cancelled or terminated housing privatization agreements, please describe the terms of the termination agreements and the terms of any legal settlements or payments resulting from prior DoD decisions to close military bases under BRAC.*
33. *Have the Navy Audit Service, US Comptroller General, or the US Government Accountability Office independently reviewed and concluded housing privatization*

*projects and the Military Services' participation in a
"housing" LLCs does not expose DoD to an unfunded contingent liability?*

*I would appreciate your response by July 22, 2005. Please provide a
control number for this request and do not hesitate to contact me if I can
provide further information concerning this request.*

Yours sincerely,

*Frank Cirillo
Director
Review & Analysis*

Sarkar, Rumu, CIV, WSO-BRAC

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Wednesday, August 03, 2005 7:58 AM
To: Barrett, Joe, CIV, WSO-BRAC
Subject: RE: Navy Privatized Housing

Many thanks!

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18
Arlington, VA 22202-3920
Tel: (703) 699-2973
Cell: (703) 901-7843
Fax: (703) 699-2735

From: Barrett, Joe, CIV, WSO-BRAC
Sent: Tuesday, August 02, 2005 4:01 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: Navy Privatized Housing

Rumu,

Thank you for the quick turn-around and excellent work

V/R

Joe N. Barrett
Senior Analyst
Navy-Marine Corps Team
BRAC Commission
703-699-2943

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Tuesday, August 02, 2005 3:55 PM
To: Hague, David, CIV, WSO-BRAC
Cc: McDaniel, Brian, CIV, WSO-BRAC; Barrett, Joe, CIV, WSO-BRAC
Subject: Navy Privatized Housing

Sir: To present some preliminary conclusions based on the doc. review that I have completed (with very able assistance and input from Brian McDaniel), it appears that with respect to the Navy's Northeast Project for privatized housing, the Navy's legal liability is limited to the amount of its pledged security of a ground lease in an amount that cannot exceed \$26 million. In all likelihood, any liability incurred will be far less.

With respect to the proposed closure of NAS New Orleans, it appears that if the DoD's recommendation to close both the East Bank (containing no residential housing units) and the West Bank are implemented, then there is a potential exposure of not more than \$23 million for the Navy for its equity contribution. If the BRAC proposal (still under consideration) is adopted, then the West Bank will remain open and will be consolidated with the Marine Corps presence which should not create any exposure or unfunded contingent liabilities for the Navy.

A memo (still in draft unless accepted as drafted) is attached giving a fuller analysis of the Northeast Project. Please let me know if you, or the Chairman, have questions wish to be briefed on this matter. Thanks, Rumu

Rumu Sarkar

Sarkar, Rumu, CIV, WSO-BRAC

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Wednesday, August 03, 2005 4:21 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Rumu,

No mas -- No more changes. I agree, the LLC can stave off insolvency as long as the rental housing market remains viable. Everything that goes up, must come down, unless its supported by the "invisible [economic] hand" of government market intervention, namely the long term viability of the Feds pumping BAH for the next 50 years into these local real estate markets.

I'll be you dollars to donuts, S&P didn't provide the LLC's bond with an investment grade rating without the invisible hand of BAH there to prop-up demand and cash flow (note they were rated by S&P's muni group based on one criteria -- essentiality of the government needed housing for military members, and not by its CMBS/real estate group; base on my professional experience with S&P that means its was highly unlikely that these bonds were ever reviewed in terms of S&P's commercial real underwriting criteria, which means no one took a hard look at underlying real estate rental market fundamental in each of the 8 locations. One more fact, S&P can change these ratings whenever it chooses to do so!

One more bet, knowing that they were unwritten, priced, and sold exclusively on the strength, longevity, and predictability of the income stream represented by BAH would be there to mitigate the investors market, price and payment risk over the life of the bonds, I am sure the spread on current deals will increase (to cover the BRAC closure risk), and I'll bet Wall Street will not jump as fast the next time a military housing "LLC" shops the same type of deal.

Thanks,
Brian

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Wednesday, August 03, 2005 4:00 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: RE: New London

Ok, I will reflect this in the memo. Any further changes from you on the memo?

Also, on further consideration on your original query on whether the DON's recommendation to close NAS facilities that have privatized housing units in the Northeast Project, two other considerations come to mind as to why bankruptcy/insolvency is unlikely. First, the AIG credit facility should cover outstanding principal and interest bond payments, so short-term cover for any cash shortfalls seem to have been provided for. Additionally, since the "sale" of the ground lease security interest means that the three properties in question at least will be completely privatized, the LLC (assuming it remains the same corporate entity under those circumstances) will no longer be restricted to BAH rates, and can charge market rates for the housing units. This, of course, assumes that the market rates are equivalent or higher to the BAH rates, thus permitting the LLC to continue making debt service payments and meet its other capital obligations. Both considerations taken together make insolvency seem even more unlikely. But we can agree to disagree on that point as well.

Rumu Sarkar
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From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Wednesday, August 03, 2005 3:35 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

We agree to disagree.

Your question may be based on a misunderstanding; mine is not a statement of fact, only an analytical assumption or hypothetical "what if". For example, if the three NE bases are closed, and these bases constitute 64% of the total number of units being financed and developed by the LLC, then what is the likely outcome if these same three bases also constitute 64% of the capital "uses" as well as provide 64% of the potential income or BAH. One can also suggest it could go up or down.

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Wednesday, August 03, 2005 3:11 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: RE: New London

I stand by my original interpretation, and note for the record that it would cause many raised eyebrows (and worse!) if I tried to represent AIG's interest. In sum, the DON's recommendation that NAS New Orleans be closed in accordance with the BRAC process does not constitute an "action" that "might cause the [LLC] to become insolvent." Not only is it too remote an action to be of the type contemplated by this provision, but it also will not have the effect of "causing" the LLC to become insolvent. As our joint memo describes, the liability of the Navy is limited to the FMV of the ground lease as mortgaged to the LLC which can be liquidated in effect in favor of the LLC, thus enabling the LLC to continue to operate a fully privatized facility with full title to and interest in the land, improvements, easements and appurtenances of the subject properties. It is still my view that it is highly unlikely that this "action" will cause (or be intended to cause) the bankruptcy or insolvency of the LLC.

A revised copy of the underlying memo (and there is a question for you buried inside) is attached. If we can wrap this up before your trip, all the better. Many thanks, Rumu

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<< File: Navy Privatized Housing Memo Revised 8-3-05 By RS.doc >>

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Tuesday, August 02, 2005 5:01 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Notwithstanding standard legal interpretation and construction, I patently disagree. The parent Article layouts the LLC's general purpose, powers, and duties. Furthermore, the clause in question simply lays out what authority the LLC doesn't have without the consent of the bond trustee, if one of its members was to A (file for Bankruptcy) OR B (take ANY ACTION that might cause the Company to become insolvent). I'll submit that it's a stretch to construe the Navy's or DOD's recommendation is such an action, but like I said, think about it as if your were AIG's counsel.

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Tuesday, August 02, 2005 1:26 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: RE: New London

Brian: In reviewing Sec. 10.02(b) of the New Orleans Navy Housing LLC Operating Agreement, the "action" being referred to is the action of filing a voluntary petition or otherwise initiating proceedings to begin bankruptcy or insolvency proceedings. Sec. 10.02(a)(ii) specifies that the Company "shall have no authority to dissolve or liquidate the Company," and the provision in question simply reiterates that for as long as the project remains outstanding, the Managing Member, Member or the Company shall not have the authority to nor may these parties initiate bankruptcy or insolvency proceedings until the Managing Member and Member (i.e., DON) approve, and the Trustee consents, to initiating such an "action." Although your interpretation is creative, it is not consistent with a reading of the plain English of this provision.

In a nutshell, I do not believe that we can infer or argue that the DON "recommendation" to close NAS New Orleans, as accepted and forwarded by the SecDef for consideration by the BRAC, is an "action" that triggers Sec. 10.02. The

"action" being referred to therein is simply that of initiating bankruptcy or insolvency proceedings in the manner specified. Thanks for bringing this provision to my attention and raising this issue with me, Rumu

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
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Arlington, VA 22202-3920
Tel: (703) 699-2973
Cell: (703) 901-7843
Fax: (703) 699-2735

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 6:35 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Rumu,

I will, but bear with me for a moment....

Please read Article X of the New Orleans' Operating Agreement in toto, paying special attention to para. 10.02(b) and 10.06.

Passage of particular interest being the following:

"...so long as the Project Debt...remains outstanding...the Member shall have no authority, unless such action has been approved by the unanimous vote of the Manager Member and the Member *and consented to by the [bond] trustee*, to...take any action that might cause the Company to become insolvent, or take any action in furtherance of any action."

I humbly submit the DON/DOD recommendation to close New London and Portsmouth is one such "action". The Navy by making any such recommendation to close an installation under BRAC -- in so doing set into motion the reasonable consequence, albeit unintended, of causing the Company -- has not only acted in bad faith and violated Article X, but it may have acted in such a way as to cause LLC's collapse.

-----Original Message-----

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 5:32 PM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: RE: New London

Brian: Take a look at the attached memo. Thanks for all your help!

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18 Arlington, VA 22202-3920
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Cell: (703) 901-7843
Fax: (703) 699-2975

-----Original Message-----

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 4:16 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Rumu,

First some additional facts for consideration:

New London, Brunswick, and Portsmouth would have 64% of the total privatized units.

Development or Total uses = \$617M, of which \$517M (84%) is being borrowed by the Company and another is covered by the MM's \$10.6M (2%) equity contribution. The Remaining \$89.4M (14%) will be pro forma reinvestment income from bond proceeds.

Of the \$617M, approx.:

\$557.7M or 83% will be used to demo, rehab, or build new houses.

\$ 23.6M will be set aside for project contingency needs, if they materialize during construction \$ 20.5M for reserve accounts for the life/maturity of the bonds (amort period is 44 years) \$ 14.6M for closing soft costs (which should have already been paid out by bond trustee at bond closing last November)

Bond amortization period is 44 years

Average Annual Debt Service (AADS) is approximately \$33M American International Insurance is technically providing the LLC with a Credit Facility - versus bond insurance policy - equal to AADS or about \$33M.

Issuer disclosed stabilized (2011) annual pro forma:

Potential Gross Income of \$87.4M

Effective Gross Income of \$71.8M

Operating Expenses of \$26.3M

Net Operating Income (NOI) of \$45.5M

Debt Service of \$34.6M

Debt Service Coverage Ratio (DSCR) of 1.31 Cash Flow Available (after Reserves and Replacement) of \$9.8

I'll come down to your office.

-----Original Message-----

From: Sarkar, Rumu, CIV, WSO-BRAC

Sent: Monday, August 01, 2005 1:40 PM

To: McDaniel, Brian, CIV, WSO-BRAC

Subject: RE: New London

As we discussed, here's a short paragraph re: privatized Navy housing for the Northeast Project for a short briefing of the Chairman later today, depending on his availability, interest, etc. Please let me know if there are any misstatements as you are ahead of me in terms of doc. review. Thanks, Rumu

The Military Housing Privatization Initiative (MHPI) is a public/private partnership whereby private sector developers may own, operate, maintain, improve and assume responsibility for military family housing under circumstances where national security is not adversely affected. The MHPI was enacted on February 10, 1996, as part of the National Defense Authorization Act for fiscal year 1996, and these authorities were made permanent by Congress in 2004. Under the MHPI authorities, the Department of Defense (DoD) can work with the private sector to revitalize and create military family housing by using a financial "toolbox" -- including direct loans, loan guarantees, equity investments, and conveying or leasing military property or facilities. The National Defense Authorization Act for Fiscal Year 2005, Public Law 108-375 107, Section 2805, provided permanent authorities to the Military Housing Privatization Initiative.

In essence, the investment authority of the MHPI, as amended, allows DoD to invest in nongovernmental entities that are, in turn, investing in the acquisition or construction of family housing and supporting facilities. These DoD investments can be in the form of limited partnerships, for which DoD provides cash, land, or facilities as equity. A limited partnership arrangement operates as a private business corporate entity, and DoD maintains that it has no part in the management of the entity.

Although no minimum cash contribution has been set for any DoD investment in a project, there is a maximum cash contribution. DoD may invest a maximum of 33.5 percent of the capital cost of a project. Since all sites and projects differ, and because the services each prioritize their own projects, the full 33.5 percent cash contribution may not be needed in each project. However, DoD also has the authority to convey land or buildings as all or part of its investment. If it chooses this route, it may not exceed 45 percent of the total capital cost if land or facilities are conveyed. For projects involving renovation, replacement, and support facilities, DoD's total equity contribution may not exceed 45 percent of a project's capital cost.

In November 2004, the Navy awarded a family housing privatization project with a total development cost of \$617.3 ,517.8 million for the privatization of 4,264 units at Navy Northeast Region. The scope includes demolition, replacement and renovation of housing units at these Navy northeast locations: Brunswick, Earle, Fairfield, Lakehurst, Mitchell, New London, Newport, Portsmouth, and Saratoga Springs. This project is currently under construction.

Since the BRAC recommendations involve complete closures of Brunswick, New London, and Portsmouth, the issue of whether these potential closures may create any unfunded contingent liabilities of the Navy/Marine Corps is being explored by BRAC staff. The Department of the Navy (DON) has responded to BRAC Commission questions through the clearinghouse, and those responses have been taken into account by the BRAC staff.

Specifically, the DON entered into a limited liability corporation, the GMH Military Housing -- Navy Northeast LLC, as a member. The private investor ("developer") is the managing member of the LLC. The DON pledged a 50-year leasehold interest in the property used to secure the Northeast Project in an amount of \$26 million as security. Please note that this is not a cash or equity investment, and that the DON asserts that it is only liable for the extent of its financial contribution to the LLC. The private developer, acting through the LLC, has issued unregistered, insured, taxable, housing revenue bonds First Tier bonds (2004-A Bonds) and Second Tier bonds (Series 2004-B Bonds) pursuant to a trust debenture agreement. JP Morgan Trust is the bond trustee, and AIG has issued bond insurance to the LLC. The bonds are NOT guaranteed by the DOD or DON (under the full faith and credit clause of the US Constitution) or insured by the DON.

The private developer has invested \$10.6 million in equity, and has raised the balance for a total of a \$517 million bond issuance pre-sold to qualified institutional investors. At least \$400 million has been deposited in the project fund for the entire Northeast Project. This means that over \$117 million has been used for construction costs, closing costs, capitalization of the reserve fund, and other capitalization costs, to date.

In the event that the closures of the three Navy facilities takes place, the Navy will have the option, as far as we are aware, of conveying the leasehold interest to the private developer to convert the Northeast Project into a 100% privatized commercial property. This means that the Navy will seek the fair market value (FMV) of the leasehold interest, and if the property rates go down as a result of the proposed closures, this may mean that the FMV of the property may decline proportionately. This means that the unsecured \$26 million leasehold interest pledged as security for the Northeast Project by the DON may be at some risk.

Alternatively, if the Navy no longer has statutory authority to continue as a member of the LLC vis-à-vis the closed facilities, the DON may be required to withdraw from the LLC as a member. If this occurs, this may mean that the bonds may need to be prepaid prior to their maturity date in 2049. The capital contained in the Project fund (approx. \$400 million) may be used for this purpose, less other costs. The Optional Redemption clause of the Final Limited Offering Memorandum may be exercised by the developer in this case. If there is a shortfall, then the AIG insurance may be necessary to cover the shortfall, depending on the terms of the insurance cover.

In a nutshell, it is unlikely, in the view of the Commission, that the Navy will incur an unfunded contingent liability as a result of bond offerings made pursuant to the Northeast project, even if the Navy's membership in the LLC is terminated due to BRAC closures since the scope of the DON's liability is limited to its security pledge of \$26 million.

The Offering Memorandum, the Leasehold Agreement and the Trust Indenture may be made available to you at your request.

Brian: let me know your thoughts. I am not altogether comfortable with the conclusions since I have not reviewed the entire documentation provided, but let me know if this summary will suffice for our purposes.

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18 Arlington, VA 22202-3920
Tel: (703) 699-2973
Cell: (703) 901-7843
Fax: (703) 699-2975

-----Original Message-----

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 9:48 AM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

I'll try to stop by your office late this afternoon.

-----Original Message-----

From: Sarkar, Rumu, CIV, WSO-BRAC

Sent: Monday, August 01, 2005 8:48 AM
To: McDaniel, Brian, CIV, WSO-BRAC
Subject: FW: New London

Need to touch base on this and other matters generally. Many thanks, Rumu

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18 Arlington, VA 22202-3920
Tel: (703) 699-2973
Cell: (703) 901-7843
Fax: (703) 699-2975

-----Original Message-----

From: Hague, David, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 8:28 AM
To: Principi, Anthony, CIV, WSO-BRAC
Cc: Sarkar, Rumu, CIV, WSO-BRAC
Subject: RE: New London

Mr. Chairman --

We have been working on the privatized housing issue and will have the info you need, if not already, soon. DAVID

-----Original Message-----

From: Principi, Anthony, CIV, WSO-BRAC
Sent: Monday, August 01, 2005 8:18 AM
To: Hague, David, CIV, WSO-BRAC
Cc: Hanna, James, CIV, WSO-BRAC
Subject: New London

David,

I would like to have one of our attorneys meet with Navy officials to discuss the long term lease contract on the privatization of military housing at New London. Specifically, I would like to know the damages that would accrue if New London was closed. Was this an issue in previous BRAC rounds? I would like to see the contract that was executed by the Navy.

Sarkar, Rumu, CIV, WSO-BRAC

*Dir. Special Ventures + Acq.
Scott Forrest, NAFAC 202-685-9333*

To: Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Hall, Craig, CIV, WSO-BRAC
Cc: Hall, Craig, CIV, WSO-BRAC; Hague, David, CIV, WSO-BRAC
Subject: FW: Privatized Housing for Navy/Marine Corps

Official Statement/Bond Indebture (BHH) - Raymond James

Just closing the loop on Navy/Marine Corps' position re: privatized housing. At the present time, the Navy (and Marine Corps) have about 15 privatized projects that are organized as either limited partnerships or limited liability companies. This means that the Navy is an investor in the private partnership, and any liability is limited to the actual investment. The private developer takes out a construction loan that is securitized by the issuance of private taxable bonds that are purchased by institutional investors. In the event of the need to terminate the Navy's limited partnership (for BRAC or other reason), then the bonds are bought back before their maturity date without any penalty to the Navy. Moreover, the Navy/MC do not issue performance guarantees for the performance of the private builder/developer, and are not required to invest more money than the original amount. The limited partnerships also have a tenant waterfall arrangement, as described in the message below. However, the Navy is not required to provide tenants to the private developer. There are no BRAC "closure clauses" as such but, as described above, in the event of a facility closure (for BRAC or other reason), the Navy/MC will simply buy back the outstanding bonds before their respective maturity dates.

All such privatized facilities are subject to 50-year leases, and the Navy/MC does not necessarily sell the underlying land to the private developer in the event of a facility closure. The land may be sold, at the Navy's option, to third parties. The assets (i.e., the housing facility or improvements made to the land) are owned by the limited partnership, and the Navy/MC makes a determination on a case-by-case basis on whether to terminate their limited partnerships. In sum, there are no anticipated outstanding legal or other associated liability or costs in relation to privatized housing facilities that the Navy or MC may have a limited partnership interest in.

*LLC - leasehold + improvements (assets)
investment - leasehold interest or sum of cash
payment risk on bonds - no obligation on
non-recourse debt
leasehold interest - must provide recourse to debt*

Please let me know if you have questions concerning this discussion. Thanks, Rumu

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Monday, June 06, 2005 10:34 AM
To: Hall, Craig, CIV, WSO-BRAC
Subject: FW: OSD Housing Privatization website

Hi Craig: Thanks for working with me on the Alaska trip. I will appreciate your getting me the name of a lawyer in Elmendorf or Richardson who may be familiar with the cross basing privatized housing issue and whether transfers of privatized housing contracts/ground leases creates potential legal liabilities (see note below). Moreover, many thanks for getting me a copy of the base site visit briefing book. Rumu

bondholder trustee (holds construction account (pt of bond indebtedure) - in trust

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Saturday, June 04, 2005 1:46 PM
To: Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'
Cc: Hague, David, CIV, WSO-BRAC
Subject: RE: OSD Housing Privatization website

I regret that another meeting prevented me from attending the meeting with Mr. Sikes on Friday, but for the record, I just wanted to give you a summary of what I discovered re: potential legal, cost and other liabilities that may arise from terminating privatized AF and Army housing projects through the BRAC closure process. The good news is that it is negligible. Mark Frazier, Deputy Chief Counsel at the AF Office of Housing Privatization in St. Antonio, TX, spoke to me at length about privatized housing projects, and there are two separate financing roles that the military can play. First, a (50-year) ground lease is entered into with the base and the private developer. If the developer can get 100% private commercial financing to build, own and operate the housing unit(s), then there's no financial role for the military to play. If a full construction loan is not available, the AF can provide a second mortgage for partial funding of the private project (e.g., 60% financing is made available by a private bank and 40% financing is made available by the AF). A second role

for the military is to issue a loan guarantee, disfavored in principle, to enable the private developer to get the construction loan and at a lower interest rate, or better financial terms based on the USG guarantee. (The Army, for example, has outstanding guarantees, as I understand it, at Fort Carson and Fort Polk.)

If the occupancy of the leased facility drops below 95% occupancy for 90 consecutive days, this triggers a "tenant waterfall" arrangement whereby eight categories of persons may be approached to fill the unoccupied units, starting with members from other service branches and ending with members of the general public. If the privatized housing project fails for any reason (e.g., the fault or non-performance of the developer) and the mortgage of the private developer is foreclosed, the developer does NOT have recourse against the USG. The USG does not guarantee performance of the developer. If the USG or the developer wish to terminate the ground lease, then the first option will be to negotiate a purchase option with the developer (even if such a clause does not exist in the original lease) for the sale of the underlying land (at fair market value) to the developer by the military. Thus, the developer may continue to own, operate and profit from the facility for the full remaining term of the 50-year ground lease. Further, if the private developer does not conform to the terms of the ground lease, then the USG can terminate the lease at no cost or legal penalty to the AF or Army.

If the lease is terminated because a BRAC closure has been scheduled, this is considered to be a termination "without clause." So-called "BRAC termination clauses," at least for the most part as far as I could determine, do not exist in such ground leases. The underlying reason for this is that military installations would not be able to attract private developers if the lease can be terminated within a few years because of BRAC closure issues. The costs of building and operating privatized housing are high enough so that such costs can only be recouped over an extended period of time. Thus, should a military installation terminate the ground lease without cause, then this would expose the USG to liability under the lease and possibly under underlying financial agreements. However, as mentioned above, the installation will seek to enter into a purchase agreement with the developer so that the project can run the length of the lease and (hopefully) generate a profit for the developer/operator.

Thus, in conclusion, there are no real anticipated costs or legal exposure from privatized housing projects in the AF and Army which explains why it was not factored into the BRAC analysis for those services. (This summary does not include the Navy.) Please let me know if you have any questions, Rumu

From: Wasleski, Marilyn, CIV, WSO-BRAC
Sent: Friday, June 03, 2005 3:23 PM
To: Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Sarkar, Rumu, CIV, WSO-BRAC
Cc: Wasleski, Marilyn, CIV, WSO-BRAC
Subject: OSD Housing Privatization website

For those in need of information on DoD's housing privatization initiative such as where they currently have privatization projects, please visit the following website:

OSD's housing privatization website is: <http://www.acq.osd.mil/housing/mhpi.htm>

If you missed this morning's meeting with the Director of OSD's Privatization Office (and the write up I prepare does not answer your questions), please call the director--Joe Sikes at (703) 602-3669.

Regards,

Marilyn
x2925

Sarkar, Rumu, CIV, WSO-BRAC

To: Epstein, David, CIV, WSO-BRAC; Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Hall, Craig, CIV, WSO-BRAC

Cc: Hall, Craig, CIV, WSO-BRAC; Hague, David, CIV, WSO-BRAC

Subject: RE: Privatized Housing for Navy/Marine Corps

Without belaboring this issue this further, let me advise you of my further discussions re: the possibility of penalties, premiums or other percentage point changes when the bonds supporting privatized housing projects may be bought back before the maturity dates. First, and foremost, I have been advised that there is no anticipated need for the Navy/MC to exit the limited partnerships that support privatize housing, and there are no potential legal or other liabilities of the Navy/MC that stem from these financing arrangements.

If the private developer who is usually the managing member of the LLC (and please note that the Navy is NEVER the managing member) faces the possibility that the occupancy for the housing in questions may fall below the 50% rate, then a decision will be made on whether to buy back some of the bonds before maturity to lower the overall debt liability of the private developer. However, the Navy does not buy back the bonds, nor can the Navy be penalized in any way for an early buy-out. This arrangement differs from most bond finance structures insofar as the Navy does not actually purchase an equity position as a member of the limited partnership (i.e., invest funds), and no underlying construction loan is entered into by the private developer (so please disregard my earlier description of this particular sliver of the transaction). Most bond financings actually start with a bank loan, and institutional investors agree to purchase bonds as evidence of the borrowers' indebtedness. Here, the Navy's Northeast Project involving 8 installations in five states, including New London, Portsmouth, and Brunswick, all of whom are affected by the BRAC process, is currently under consideration by the private developer(s) to decide on whether early bond buy-backs will be initiated.

Please note that the fixed rate bond financing arrangement is entered into through one LLC with one operating agreement (i.e., one debt instrument). The private developer issues the bonds that are then bought by institutional investors. The cash is deposited in a construction escrow account managed by a trustee, and the income stream generated by existing housing being refurbished by the private developer is deposited into the escrow account. That income stream pays back principal and interest to the bondholders as well as to the construction contractor(s) for work performed on the housing units.

The "no penalty" clause is tied to the bond docs., and I have been assured that even if there were a penalty assessed, it would not be against or payable by the Navy. The Navy does give a 50-year lease to the private developer and, as discussed below, may decide to sell the underlying realty to a third party at its discretion. However, as mentioned above, there is no anticipated need for the Navy/MC to exit these private partnerships or the leaseholds that support privatized housing. Thanks, Rumu

From: Epstein, David, CIV, WSO-BRAC
Sent: Thursday, June 09, 2005 8:20 AM
To: Sarkar, Rumu, CIV, WSO-BRAC; Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Hall, Craig, CIV, WSO-BRAC
Cc: Hall, Craig, CIV, WSO-BRAC; Hague, David, CIV, WSO-BRAC
Subject: RE: Privatized Housing for Navy/Marine Corps

Rumu:

In your explanation of the non-liability of the Navy for privatized housing, you wrote that "in the event of the need to terminate the Navy's limited partnership, then the bonds are bought back before their maturity date without any penalty to the Navy. My limited knowledge of the way in which bonds work is that if the Navy is no longer going to stand behind a project, the interest rate that investors demand will rise by at least one percent and probably more. When interest rates rise on a long term bond, the value of the bond will plummet and bond-holders would probably sue the Navy and the developer unless the documentation that made the offering made this eventuality clear. Furthermore, the Navy (and possibly the other Services) would likely decide that they had better pay off the partners and bond holders or they will be unable to do future public-private ventures. In short, I am not comfortable with the apparent conclusion that there is no

liability on the part of the Navy.

Please pass this up the chain if you think that it has any merit. You might want to get Duke, as an economist, or someone who really understands bonds to review this and/or to rewrite it more eloquently and correctly.

David

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Wednesday, June 08, 2005 2:56 PM
To: Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Hall, Craig, CIV, WSO-BRAC
Cc: Hall, Craig, CIV, WSO-BRAC; Hague, David, CIV, WSO-BRAC
Subject: FW: Privatized Housing for Navy/Marine Corps

Just closing the loop on Navy/Marine Corps' position re: privatized housing. At the present time, the Navy (and Marine Corps) have about 15 privatized projects that are organized as either limited partnerships or limited liability companies. This means that the Navy is an investor in the private partnership, and any liability is limited to the actual investment. The private developer takes out a construction loan that is securitized by the issuance of private taxable bonds that are purchased by institutional investors. In the event of the need to terminate the Navy's limited partnership (for BRAC or other reason), then the bonds are bought back before their maturity date without any penalty to the Navy. Moreover, the Navy/MC do not issue performance guarantees for the performance of the private builder/developer, and are not required to invest more money than the original amount. The limited partnerships also have a tenant waterfall arrangement, as described in the message below. However, the Navy is not required to provide tenants to the private developer. There are no BRAC "closure clauses" as such but, as described above, in the event of a facility closure (for BRAC or other reason), the Navy/MC will simply buy back the outstanding bonds before their respective maturity dates.

All such privatized facilities are subject to 50-year leases, and the Navy/MC does not necessarily sell the underlying land to the private developer in the event of a facility closure. The land may be sold, at the Navy's option, to third parties. The assets (i.e., the housing facility or improvements made to the land) are owned by the limited partnership, and the Navy/MC makes a determination on a case-by-case basis on whether to terminate their limited partnerships. In sum, there are no anticipated outstanding legal or other associated liability or costs in relation to privatized housing facilities that the Navy or MC may have a limited partnership interest in.

Please let me know if you have questions concerning this discussion. Thanks, Rumu

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Monday, June 06, 2005 10:34 AM
To: Hall, Craig, CIV, WSO-BRAC
Subject: FW: OSD Housing Privatization website

Hi Craig: Thanks for working with me on the Alaska trip. I will appreciate your getting me the name of a lawyer in Elmendorf or Richardson who may be familiar with the cross basing privatized housing issue and whether transfers of privatized housing contracts/ground leases creates potential legal liabilities (see note below). Moreover, many thanks for getting me a copy of the base site visit briefing book. Rumu

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Saturday, June 04, 2005 1:46 PM
To: Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'
Cc: Hague, David, CIV, WSO-BRAC
Subject: RE: OSD Housing Privatization website

I regret that another meeting prevented me from attending the meeting with Mr. Sikes on Friday, but for the record, I just wanted to give you a summary of what I discovered re: potential legal, cost and other liabilities that may arise from terminating privatized AF and Army housing projects through the BRAC closure process. The good news is that it is negligible. Mark Frazier,, Deputy Chief Counsel at the AF Office of Housing Privatization in St. Antonio, TX, spoke to me at length about privatized housing projects, and there are two separate financing roles that the military can play. First, a

(50-year) ground lease is entered into with the base and the private developer. If the developer can get 100% private commercial financing to build, own and operate the housing unit(s), then there's no financial role for the military to play. If a full construction loan is not available, the AF can provide a second mortgage for partial funding of the private project (e.g., 60% financing is made available by a private bank and 40% financing is made available by the AF). A second role for the military is to issue a loan guarantee, disfavored in principle, to enable the private developer to get the construction loan and at a lower interest rate, or better financial terms based on the USG guarantee. (The Army, for example, has outstanding guarantees, as I understand it, at Fort Carson and Fort Polk.)

If the occupancy of the leased facility drops below 95% occupancy for 90 consecutive days, this triggers a "tenant waterfall" arrangement whereby eight categories of persons may be approached to fill the unoccupied units, starting with members from other service branches and ending with members of the general public. If the privatized housing project fails for any reason (e.g., the fault or non-performance of the developer) and the mortgage of the private developer is foreclosed, the developer does NOT have recourse against the USG. The USG does not guarantee performance of the developer. If the USG or the developer wish to terminate the ground lease, then the first option will be to negotiate a purchase option with the developer (even if such a clause does not exist in the original lease) for the sale of the underlying land (at fair market value) to the developer by the military. Thus, the developer may continue to own, operate and profit from the facility for the full remaining term of the 50-year ground lease. Further, if the private developer does not conform to the terms of the ground lease, then the USG can terminate the lease at no cost or legal penalty to the AF or Army.

If the lease is terminated because a BRAC closure has been scheduled, this is considered to be a termination "without clause." So-called "BRAC termination clauses," at least for the most part as far as I could determine, do not exist in such ground leases. The underlying reason for this is that military installations would not be able to attract private developers if the lease can be terminated within a few years because of BRAC closure issues. The costs of building and operating privatized housing are high enough so that such costs can only be recouped over an extended period of time. Thus, should a military installation terminate the ground lease without cause, then this would expose the USG to liability under the lease and possibly under underlying financial agreements. However, as mentioned above, the installation will seek to enter into a purchase agreement with the developer so that the project can run the length of the lease and (hopefully) generate a profit for the developer/operator.

Thus, in conclusion, there are no real anticipated costs or legal exposure from privatized housing projects in the AF and Army which explains why it was not factored into the BRAC analysis for those services. (This summary does not include the Navy.) Please let me know if you have any questions, Rumu

From: Wasleski, Marilyn, CIV, WSO-BRAC
Sent: Friday, June 03, 2005 3:23 PM
To: Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Sarkar, Rumu, CIV, WSO-BRAC
Cc: Wasleski, Marilyn, CIV, WSO-BRAC
Subject: OSD Housing Privatization website

For those in need of information on DoD's housing privatization initiative such as where they currently have privatization projects, please visit the following website:

OSD's housing privatization website is: <http://www.acq.osd.mil/housing/mhpi.htm>

If you missed this morning's meeting with the Director of OSD's Privatization Office (and the write up I prepare does not answer your questions), please call the director--Joe Sikes at (703) 602-3669.

Regards,

Marilyn
x2925

Sarkar, Rumu, CIV, WSO-BRAC

To: Wasleski, Marilyn, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'

Cc: Hague, David, CIV, WSO-BRAC

Subject: RE: OSD Housing Privatization website

I regret that another meeting prevented me from attending the meeting with Mr. Sikes on Friday, but for the record, I just wanted to give you a summary of what I discovered re: potential legal, cost and other liabilities that may arise from terminating privatized AF and Army housing projects through the BRAC closure process. The good news is that it is negligible. Mark Frazier, Deputy Chief Counsel at the AF Office of Housing Privatization in St. Antonio, TX, spoke to me at length about privatized housing projects, and there are two separate financing roles that the military can play. First, a (50-year) ground lease is entered into with the base and the private developer. If the developer can get 100% private commercial financing to build, own and operate the housing unit(s), then there's no financial role for the military to play. If a full construction loan is not available, the AF can provide a second mortgage for partial funding of the private project (e.g., 60% financing is made available by a private bank and 40% financing is made available by the AF). A second role for the military is to issue a loan guarantee, disfavored in principle, to enable the private developer to get the construction loan and at a lower interest rate, or better financial terms based on the USG guarantee. (The Army, for example, has outstanding guarantees, as I understand it, at Fort Carson and Fort Polk.)

If the occupancy of the leased facility drops below 95% occupancy for 90 consecutive days, this triggers a "tenant waterfall" arrangement whereby eight categories of persons may be approached to fill the unoccupied units, starting with members from other service branches and ending with members of the general public. If the privatized housing project fails for any reason (e.g., the fault or non-performance of the developer) and the mortgage of the private developer is foreclosed, the developer does NOT have recourse against the USG. The USG does not guarantee performance of the developer. If the USG or the developer wish to terminate the ground lease, then the first option will be to negotiate a purchase option with the developer (even if such a clause does not exist in the original lease) for the sale of the underlying land (at fair market value) to the developer by the military. Thus, the developer may continue to own, operate and profit from the facility for the full remaining term of the 50-year ground lease. Further, if the private developer does not conform to the terms of the ground lease, then the USG can terminate the lease at no cost or legal penalty to the AF or Army.

If the lease is terminated because a BRAC closure has been scheduled, this is considered to be a termination "without clause." So-called "BRAC termination clauses," at least for the most part as far as I could determine, do not exist in such ground leases. The underlying reason for this is that military installations would not be able to attract private developers if the lease can be terminated within a few years because of BRAC closure issues. The costs of building and operating privatized housing are high enough so that such costs can only be recouped over an extended period of time. Thus, should a military installation terminate the ground lease without cause, then this would expose the USG to liability under the lease and possibly under underlying financial agreements. However, as mentioned above, the installation will seek to enter into a purchase agreement with the developer so that the project can run the length of the lease and (hopefully) generate a profit for the developer/operator.

Thus, in conclusion, there are no real anticipated costs or legal exposure from privatized housing projects in the AF and Army which explains why it was not factored into the BRAC analysis for those services. (This summary does not include the Navy.) Please let me know if you have any questions, Rumu

From: Wasleski, Marilyn, CIV, WSO-BRAC
Sent: Friday, June 03, 2005 3:23 PM
To: Cirillo, Frank, CIV, WSO-BRAC; Cook, Robert, CIV, WSO-BRAC; Robertson, Kathleen, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Sillin, Nathaniel, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Tran, Duke, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Abrell, Timothy, MAJ, WSO-BRAC; 'carol.schmitt@wso.whs.mil'; Sarkar, Rumu, CIV, WSO-BRAC
Cc: Wasleski, Marilyn, CIV, WSO-BRAC
Subject: OSD Housing Privatization website

For those in need of information on DoD's housing privatization initiative such as where they currently have privatization projects, please visit the following website:

OSD's housing privatization website is: <http://www.acq.osd.mil/housing/mhpi.htm>

If you missed this morning's meeting with the Director of OSD's Privatization Office (and the write up I prepare does not answer your questions), please call the director--Joe Sikes at (703) 602-3669.

Regards,

Marilyn
x2925

Sarkar, Rumu, CIV, WSO-BRAC

From: Connor, Mark J Mr OGC [Mark.Connor@hqda.army.mil]
Sent: Wednesday, June 01, 2005 1:31 PM
To: 'Sarkar, Rumu, CIV, WSO-BRAC'
Subject: RE: Housing Question

Speaking only to Army RCI projects the impact of BRAC is negligible - with the exception of Forts Carson and Polk, the Army has not guaranteed any element of an RCI Project's financial health - if a Project (other than Carson and Polk which have limited Base Closure guarantees) runs into financial difficulty because the population of soldiers is reduced due to BRAC (or any other reason), the Army has NO liability to either the developer or the lenders. In an Army RCI transaction, no agreement (to include the Ground Lease and Operating/Partnership Agreement) is terminated because of BRAC - in essence, the Project continues to operate by seeking other tenants - including, as a last resort, members of the general public. If the Project fails because it cannot attract enough tenants, the lender can foreclose the loan but has no recourse against the United States for any deficiency - the lender can then choose to operate the Project consistent with the terms of the Ground Lease - if the Lender either cannot or will not operate the Project consistent with the Ground Lease, the Army can terminate the Ground Lease for default and ownership of the improvements on the leasehold reverts to the United States at no cost.

From: Sarkar, Rumu, CIV, WSO-BRAC [mailto:rumu.sarkar@wso.whs.mil]
Sent: Wednesday, June 01, 2005 12:34 PM
To: Connor, Mark J Mr OGC
Subject: Housing Question

Hello Mr. Connor: I understand that you work on housing-related issues, and a question has arisen in relation to the BRAC process. I have been advised that there is some concern that DoD's calculations of potential costs savings as well as expenses (and incurring potential legal liabilities) was not factored into the underlying data supporting the BRAC list. In particular, it is my understanding based on information filtering back from site visits being made by BRAC Commissioners that the cost of terminating contracts with privatized entities that built private housing facilities and that have long-term leases to rent such facilities to servicemen and women may risk having those leases terminated. I believe these lease arrangements may be part of the Residential Community Initiative (RCI), and may involve potentially significant legal liabilities and costs associated with terminating those agreements, especially as an income stream generated from basing housing allowances paid for by the individual services may now be lost if the military installations where such residential units are located become subject to closure or realignment.

If you have any insights on this issue (particularly with regard to potential legal liability and associated costs), please advise me or direct me to the persons or resources I may use to further explore this issue. I appreciate your assistance and understand that you are currently on TDY. Please feel free to call or e-mail me, whichever is more convenient for you.

Many thanks, Rumu Sarkar

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18
Arlington, VA 22202-3920
Tel: (703) 699-2973
Fax: (703) 699-2975
Cell: (703) 901-7843

6/1/2005

Mark Frazier: AF Privatized Housing (St. Antonio, TX)

Project owner - 50 yr. lease (ground lease)

Purchase option - purchase land + continue housing project
FMV for land

AF - 3 projects w/ purchase option

11 projects - AF w/ no purchase option

if drop in occupancy (BRAC or otherwise) - tenant waterfall

8 categories of other potential tenants (eg: other services)
triggered if drop in occupancy below 95% for 90 days (consy.)

Construction loan to build housing project

- if 100% financed by private lender - OK

- if not, balance of financing provided by AF loan (2d lien)

- 1/3 by AF possible, to help private developer get loan (mortgage)

If ground lease terminated w/out cause (eg BRAC closure) -

private developer forecloses mortgage - resulting recourse to
liability of AF

No BRAC termination clause - no not cause

no rt. to terminate b/c of BRAC

nego. purchase option (even if one doesn't exist) - to
help developer/owner/operator continue for 50 yr. lease

if lease terminated for fault, non-performance - no recourse to AF
AF does not guarantee performance

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Site last updated on 05/25/2005

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Contact Information

AF/ILEHM
AF Deputy Chief of Staff
Installation and Logistics Privatization Division

HQ AFCEE/HDP
Housing Directorate's Privatization Division

Legal Division Contacts

**Office of the Deputy General Counsel
 (Installations & Environment)**

Office of the Deputy General Counsel
 Air Force Housing Privatization Center for Excellence
 2735 Louis Bauer Drive, Bldg 728
 Brooks City-Base, TX 78235-5133

Chief Legal Counsel

Gordon O. Tanner
 Chief Counsel, Legal Division
 (210) 536-8174 DSN 240-8174

✓ **Mark E. Frazier**
 Deputy Chief Counsel, Legal Division
 (210) 536-8784 DSN 240-8784

Senior Legal Counsel

Cynthia A. Stephens
 Senior Counsel, Legal Division
 (210) 536-5282 DSN 240-5282

Fraser Jones
 Senior Counsel, Legal Division
 (210) 536-4188 DSN 240-4188

Janene Forster
 Senior Counsel, Legal Division
 (210) 536-5669 DSN 240-5669

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Sarkar, Rumu, CIV, WSO-BRAC

From: Hague, David, CIV, WSO-BRAC
Sent: Wednesday, June 01, 2005 5:30 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: Re: Housing Question

Thanks Rumu. My guess is that Navy and AF input will be similiar.

David

-----Original Message-----

From: Sarkar, Rumu, CIV, WSO-BRAC <rumu.sarkar@wso.whs.mil>
To: Hague, David, CIV, WSO-BRAC <David.Hague@wso.whs.mil>
CC: Cowhig, Dan, CIV, WSO-BRAC <Dan.Cowhig@wso.whs.mil>
Sent: Wed Jun 01 17:13:47 2005
Subject: FW: Housing Question

The e-mail I received below is helpful, but only a partial answer. I'm still looking for an AF and Navy response, Rumu

From: Sarkar, Rumu, CIV, WSO-BRAC
Sent: Wednesday, June 01, 2005 1:38 PM
To: Connor, Mark J Mr OGC
Subject: RE: Housing Question

Thanks for the speedy and thorough response. Do you know if similar arrangements exist for the Air Force and Navy re: same?

From: Connor, Mark J Mr OGC [mailto:Mark.Connor@hqda.army.mil]
Sent: Wednesday, June 01, 2005 1:31 PM
To: 'Sarkar, Rumu, CIV, WSO-BRAC'
Subject: RE: Housing Question

(703) 693-3024

Speaking only to Army RCI projects the impact of BRAC is negligible - with the exception of Forts Carson and Polk, the Army has not guaranteed any element of an RCI Project's financial health - if a Project (other than Carson and Polk which have limited Base Closure guarantees) runs into financial difficulty because the population of soldiers is reduced due to BRAC (or any other reason), the Army has NO liability to either the developer or the lenders. In an Army RCI transaction, no agreement (to include the Ground Lease and Operating/Partnership Agreement) is terminated because of BRAC - in essence, the Project continues to operate by seeking other tenants - including, as a last resort, members of the general public. If the Project fails because it cannot attract enough tenants, the lender can foreclose the loan but has no recourse against the United States for any deficiency - the lender can then choose to operate the Project consistent with the terms of the Ground Lease - if the Lender either cannot or will not operate the Project consistent with the Ground Lease, the Army can terminate the Ground Lease for default and ownership of the improvements on the leasehold reverts to the United States at no cost.

From: Sarkar, Rumu, CIV, WSO-BRAC [mailto:rumu.sarkar@wso.whs.mil]
Sent: Wednesday, June 01, 2005 12:34 PM
To: Connor, Mark J Mr OGC
Subject: Housing Question

Hello Mr. Connor: I understand that you work on housing-related issues, and a question has arisen in relation to the BRAC process. I have been advised that there is some concern that DoD's calculations of potential costs savings as well as expenses (and incurring potential legal liabilities) was not factored into the underlying data supporting the BRAC list. In particular, it is my understanding based on information filtering back from site visits being made by BRAC Commissioners that the cost of terminating contracts with privatized entities that built private housing facilities and that have long-term leases to rent such facilities to servicemen and women may risk having those leases terminated. I believe these lease arrangements may be part of the Residential Community Initiative (RCI), and may involve potentially significant legal liabilities and costs associated with terminating those agreements, especially as an income stream generated from basing housing allowances paid for by the individual services may now be lost if the military installations where such residential units are located become subject to closure or realignment.

If you have any insights on this issue (particularly with regard to potential legal liability and associated costs), please advise me or direct me to the persons or resources I may use to further explore this issue. I appreciate your assistance and understand that you are currently on TDY. Please feel free to call or e-mail me, whichever is more convenient for you.

Many thanks, Rumu Sarkar

Rumu Sarkar
Associate General Counsel
2005 Defense Base Closure and Realignment Commission
2521 South Clark Street, Suite 600, Room 600-18
Arlington, VA 22202-3920
Tel: (703) 699-2973
Fax: (703) 699-2975
Cell: (703) 901-7843

Sarkar, Rumu, CIV, WSO-BRAC

From: Epstein, David, CIV, WSO-BRAC
Sent: Thursday, June 02, 2005 9:47 AM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: FW: Long Term Contracts for Housing

Rumu:
It was the following email, which I sent on Tuesday evening, that started the recognition of the contract housing issue.

David

-----Original Message-----

From: Epstein, David, CIV, WSO-BRAC
Sent: Tuesday, May 31, 2005 5:36 PM
To: Biddick, Dennis CIV
Cc: Hanna, James, CIV, WSO-BRAC; McDaniel, Brian, CIV, WSO-BRAC; Hague, David, CIV, WSO-BRAC
Subject: FW: Long Term Contracts for Housing

Dennis:

This is a multi-part request. You may be able to perform some pieces simultaneously.

- 1) Provide us with a list of all existing and currently being negotiated public/private ventures (e.g., housing or other privatization, limited liability corporations, outleases, or other real estate transactions) for family or bachelor housing, hotels, office buildings, etc. Each of these should be identified as to the recommendation(s) that are affected, including the specific military installation and the number of housing or other units involved if the recommendation affects more than one losing or closing base.
- 2) Please have NAVY OGC provide the Navy team with a formal written opinion, to be provided within two weeks, as to the Navy's actual and potential liability under all existing and currently being negotiated public/private ventures (e.g., housing or other privatization, limited liability corporations, outleases, or other real estate transactions) for family or bachelor housing, hotels, office buildings, etc.
- 3) Separately, please also assess the likelihood that a judgement will be reached and the potential cost by recommendation geographical area. This issue is probably most significant in rural areas such as Crane and to a lesser degree in place like Dahlgren. This opinion should include all contracts with details regarding the potential liability by base, with details to include the number of housing units, liability, the term, and estimated amount of private investment/debt.

Also, please address the question as to how these "termination costs" were accounted for in the COBRA reports with which we have been provided.

This request has been approved by Mr. Hanna on a conceptual level. The email was prepared by Brian McDaniel and David Epstein. The three of us can be reached at x2917, x2945, and x2947, respectively.

David Epstein

I just received an email from Dahlgren personnel who wrote that the Navy is scheduled to sign a contract in about two months that would obligate the Navy in Dahlgren and elsewhere for 50 years.

David



Sarkar, Rumu, CIV, WSO-BRAC

From: McDaniel, Brian, CIV, WSO-BRAC
Sent: Thursday, June 23, 2005 1:42 PM
To: Sarkar, Rumu, CIV, WSO-BRAC
Subject: FW: Housing Privatization Memorandum of Meeting

Attachments: Housing Privatization Memorandum of Meeting.doc



Housing
Privatization Memorandum
Rumu,

I have some experience with similar bond transactions (although not using a LP or LLC) structured for civilian agencies totally about \$200 million over the last few years, and I was wondering if you might have some time to discuss with me your recent conversation (as outlined in Marilyn's MOM) with AF, USA, and Navy OGC attorneys regarding their opinion on whether or not these housing privatization legal/financial structures might trigger the creation of financial/budget obligations (i.e., an unfunded contingent Liability under federal appropriation law) for a DoD recommended closure, and consequently reducing DoD's estimate of savings.

I am particularly interested in any potential "meltdown" scenarios that could possibly be associated with the Navy housing LLC in the northeast (New London, Portsmouth), especially as to which member of the LLC bears 100% of the payment obligation to the bond trustee/investors. Also, in your discussions with the GCs, did they mention if the LLC were covering their payment risk by transferring it to a bond insure such as MBIA or AMBAC?

I am curious, did the OGC attorneys you talked to offer to provide you/the Commission with any legal opinions the Services/DoD may have been required to issue as part of the bond transactions, or offered to provide you with a copy of the legal/commercial documents (e.g, the bond indenture agreement, bond purchase agreement, leasehold mortgage or related security agreements, or potential investors' Official Statement (typically referred to as an OS) so the Commission could satisfy its own due diligence needs?

Thank you,
Brian

From: Wasleski, Marilyn, CIV, WSO-BRAC
Sent: Monday, June 20, 2005 7:16 PM
To: Cook, Robert, CIV, WSO-BRAC; Cirillo, Frank, CIV, WSO-BRAC; Small, Kenneth, CIV, WSO-BRAC; Van Saun, David, CIV, WSO-BRAC; Epstein, David, CIV, WSO-BRAC; Saxon, Ethan, CIV, WSO-BRAC; Hanna, James, CIV, WSO-BRAC; Dinsick, Robert, CIV, WSO-BRAC; Combs, David, CIV, WSO-BRAC; Sarkar, Rumu, CIV, WSO-BRAC
Cc: Wasleski, Marilyn, CIV, WSO-BRAC
Subject: Housing Privatization Memorandum of Meeting

Attached is the write up with the OSD's Director of Competitive Sourcing and Privatization. It concerns the housing privatization issue. Please pass along to those who need to know.

Thanks.

Marilyn

***DEFENSE BASE CLOSURE AND REALIGNMENT COMMISSION
2521 CLARK STREET, SUITE 600
ARLINGTON, VIRGINIA 22202
(703) 699-2950***

MEMORANDUM OF MEETING

DATE: June 3, 2005

TIME: 10:00 a.m.

MEETING WITH: Joe Sikes, Director, OSD Office of Competitive Sourcing and Privatization

SUBJECT: To discuss how BRAC will affect DOD's housing privatization initiative.

PARTICIPANTS:

Commission Staff:

Frank Cirillo, Director of Review & Analysis, (703) 699-2903
Jim Hanna, Navy Team Leader, (703) 699-2917
Bob Cook, Interagency Issues Team Leader (703) 699-2902
Kathleen Robertson, Deputy Joint Cross-Service Team Leader, (703) 699-2909
David Combs, Air Force Team Senior Analyst, (703) 699-2933
*Marilyn Wasleski, Interagency Deputy Team Leader/Senior Analyst,
(703) 699-2925
Karl Gringrich, Interagency Team/COBRA, (703) 699-2923
Duke Tran, Interagency Team/Economist, (703) 699-2924
Rumu Sakar, BRAC Associate Counsel, (703) 699-2973

OSD Office of Competitive Sourcing and Privatization:

Joe Sikes, Director, (703) 602-3669
Bob Helwig, Deputy Director, (703) 602-9867
Robin Williams, Intern

MEETING SUMMARY:

Note: Prior and after the meeting the BRAC Associate Counsel provided the following information on the impact of BRAC on DoD's housing privatization project.

I regret that another meeting prevented me from attending the meeting with Mr. Sikes on Friday, but for the record, I just wanted to give you a summary of what I discovered re: potential legal, cost and other liabilities that may arise from terminating privatized AF and Army housing projects through the BRAC

closure process. The good news is that it is negligible. Mark Frazier, Deputy Chief Counsel at the AF Office of Housing Privatization in St. Antonio, TX, spoke to me at length about privatized housing projects, and there are two separate financing roles that the military can play. First, a (50-year) ground lease is entered into with the base and the private developer. If the developer can get 100% private commercial financing to build, own and operate the housing unit(s), then there's no financial role for the military to play. If a full construction loan is not available, the AF can provide a second mortgage for partial funding of the private project (e.g., 60% financing is made available by a private bank and 40% financing is made available by the AF). A second role for the military is to issue a loan guarantee, disfavored in principle, to enable the private developer to get the construction loan and at a lower interest rate, or better financial terms based on the USG guarantee. (The Army, for example, has outstanding guarantees, as I understand it, at Fort Carson and Fort Polk.)

If the occupancy of the leased facility drops below 95% occupancy for 90 consecutive days, this triggers a "tenant waterfall" arrangement whereby eight categories of persons may be approached to fill the unoccupied units, starting with members from other service branches and ending with members of the general public. If the privatized housing project fails for any reason (e.g., the fault or non-performance of the developer) and the mortgage of the private developer is foreclosed, the developer does NOT have recourse against the USG. The USG does not guarantee performance of the developer. If the USG or the developer wish to terminate the ground lease, then the first option will be to negotiate a purchase option with the developer (even if such a clause does not exist in the original lease) for the sale of the underlying land (at fair market value) to the developer by the military. Thus, the developer may continue to own, operate and profit from the facility for the full remaining term of the 50-year ground lease. Further, if the private developer does not conform to the terms of the ground lease, then the USG can terminate the lease at no cost or legal penalty to the AF or Army.

If the lease is terminated because a BRAC closure has been scheduled, this is considered to be a termination "without cause." So-called "BRAC termination clauses," at least for the most part as far as I could determine, do not exist in such ground leases. The underlying reason for this is that military installations would not be able to attract private developers if the lease can be terminated within a few years because of BRAC closure issues. The costs of building and operating privatized housing are high enough so that such costs can only be recouped over an extended period of time. Thus, should a military installation terminate the ground lease without cause, then this would expose the USG to liability under the lease and possibly under underlying financial agreements. However, as mentioned above, the installation will seek to enter into a purchase agreement with the developer so that the project can run the length of the lease and (hopefully) generate a profit for the developer/operator.

Speaking only to Army RCI projects the impact of BRAC is negligible - with the exception of Forts Carson and Polk, the Army has not guaranteed any element of an RCI Project's financial health - if a Project (other than Carson and Polk which have limited Base Closure guarantees) runs into financial difficulty because the population of soldiers is reduced due to BRAC (or any other reason), the Army has NO liability to either the developer or the lenders. In an Army RCI transaction, no agreement (to include the Ground Lease and Operating/Partnership Agreement) is terminated because of BRAC - in essence, the Project continues to operate by seeking other tenants - including, as a last resort, members of the general public. If the Project fails because it cannot attract enough tenants, the lender can foreclose the loan but has no recourse against the United States for any deficiency - the lender can then choose to operate the Project consistent with the terms of the Ground Lease - if the Lender either cannot or will not operate the Project consistent with the Ground Lease, the Army can terminate the Ground Lease for default and ownership of the improvements on the leasehold reverts to the United States at no cost.

Thus, in conclusion, there are no real anticipated costs or legal exposure from privatized housing projects in the AF and Army which explains why it was not factored into the BRAC analysis for those services. (This summary does not include the Navy.)

Just closing the loop on Navy/Marine Corps' position re: privatized housing. At the present time, the Navy (and Marine Corps) have about 15 privatized projects that are organized as either limited partnerships or limited liability companies. This means that the Navy is an investor in the private partnership, and any

liability is limited to the actual investment. The private developer takes out a construction loan that is securitized by the issuance of private taxable bonds that are purchased by institutional investors. In the event of the need to terminate the Navy's limited partnership (for BRAC or other reason), then the bonds are bought back before their maturity date without any penalty to the Navy. Moreover, the Navy/MC do not issue performance guarantees for the performance of the private builder/developer, and are not required to invest more money than the original amount. The limited partnerships also have a tenant waterfall arrangement, as described in the message below. However, the Navy is not required to provide tenants to the private developer. There are no BRAC "closure clauses" as such but, as described above, in the event of a facility closure (for BRAC or other reason), the Navy/MC will simply buy back the outstanding bonds before their respective maturity dates.

All such privatized facilities are subject to 50-year leases, and the Navy/MC does not necessarily sell the underlying land to the private developer in the event of a facility closure. The land may be sold, at the Navy's option, to third parties. The assets (i.e., the housing facility or improvements made to the land) are owned by the limited partnership, and the Navy/MC makes a determination on a case-by-case basis on whether to terminate their limited partnerships. In sum, there are no anticipated outstanding legal or other associated liability or costs in relation to privatized housing facilities that the Navy or MC may have a limited partnership interest in.

Without belaboring this issue this further, let me advise you of my further discussions re: the possibility of penalties, premiums or other percentage point changes when the bonds supporting privatized housing projects may be bought back before the maturity dates. First, and foremost, I have been advised that there is no anticipated need for the Navy/MC to exit the limited partnerships that support privatize housing, and there are no potential legal or other liabilities of the Navy/MC that stem from these financing arrangements.

If the private developer who is usually the managing member of the LLC (and please note that the Navy is NEVER the managing member) faces the possibility that the occupancy for the housing in questions may fall below the 50% rate, then a decision will be made on whether to buy back some of the bonds before maturity to lower the overall debt liability of the private developer. However, the Navy does not buy back the bonds, nor can the Navy be penalized in any way for an early buy-out. This arrangement differs from most bond finance structures insofar as the Navy does not actually purchase an equity position as a member of the limited partnership (i.e., invest funds), and no underlying construction loan is entered into by the private developer (so please disregard my earlier description of this particular sliver of the transaction). Most bond financings actually start with a bank loan, and institutional investors agree to purchase bonds as evidence of the borrowers' indebtedness. Here, the Navy's Northeast Project involving 8 installations in five states, including New London, Portsmouth, and Brunswick, all of whom are affected by the BRAC process, is currently under consideration by the private developer(s) to decide on whether early bond buy-backs will be initiated.

Please note that the fixed rate bond financing arrangement is entered into through one LLC with one operating agreement (i.e., one debt instrument). The private developer issues the bonds that are then bought by institutional investors. The cash is deposited in a construction escrow account managed by a trustee, and the income stream generated by existing housing being refurbished by the private developer is deposited into the escrow account. That income stream pays back principal and interest to the bondholders as well as to the construction contractor(s) for work performed on the housing units.

The "no penalty" clause is tied to the bond docs., and I have been assured that even if there were a penalty assessed, it would not be against or payable by the Navy. The Navy does give a 50-year lease to the private developer and, as discussed below, may decide to sell the underlying realty to a third party at its discretion. However, as mentioned above, there is no anticipated need for the Navy/MC to exit these private partnerships or the leaseholds that support privatized housing.

The following information was provided by Joe Sikes.

Housing on BRAC Closing Sites

Mr. Sikes confirmed what Ms. Sakar stated above that overall if a base closes where DoD has a housing privatization project there are legal issues for DoD. This is because DoD did not enter into any contracts with the developers. They entered into leases. The Army and the Navy operate under Limited Liability Corporations. There are no BRAC guarantees, except for a few bases that they did in the beginning of the program—Lackland, Carson, Robbins. In fact, Mr. Sikes said that these projects should continue to work well for the developer because they are financed at lower rates. (Note: Mr. Sikes provided paper that Standard & Poors issued on May 25, 2005 on the Economic Impact of the Defense Department's Base Closure Proposals.)

The government owns the ground while the developer owns the homes. If the developer cannot find favorable financing, the government can finance up to 20%.

If the developer cannot fill the housing units with military personnel there is list of people that he can then try and rent the houses to. This list is known as a "waterfall". The order is first military families, unaccompanied military member, retirees, DoD Civilians, lastly, the general public. However, leases to other than the military can only be for one year. This will allow them to open up again to a military family. For example, in Corpus Christi, Texas, the housing units were built before the military being assigned to the area arrived. Therefore, in the beginning only about half the units were occupied by military personnel.

Military essential housing, such as the base commander's home and other reserved housing units, are not allowed to be leased to others in the "waterfall". Further, historic properties must be maintained as such by the developer.

Mr. Sikes feels that that housing privatization program has been a good new story because it allows the developer the ability to rent to all parties, if necessary.

BRAC Gaining Sites

The issue for gaining sites is how much housing to build. The rule is to assume the percentage that currently lives on base. So, if 30% of the families currently live on base, the services will be allowed to be building 30% more homes on base. The rest will have to be handled through the local market or the housing privatization initiative. Mr. Sikes believes that the local market will build to meet the demand. However, if they see that the market is not meeting the demand, DoD will step in and build more houses. Each of the services for the BRAC process were tasked to do a market analysis for gaining sites to determine if the housing in the area will meet the increased demand. He said that the services contracted out this effort. Mr. Sikes said this type of analysis is an art not a science. This is because you cannot predict with 100% accuracy where a service member will choose to live. The DoD policy of allowing for one bedroom per child was incorporated into the market analysis. However, Mr. Sikes does not believe that this is realistic standard today.

Mr. Sikes believes that the services are losing a good income stream as they currently only charge the basic housing allowance for homes. So, for example, a military service member can live in a three bedroom house but be charged only for a two bedroom apartment.

Mr. Sikes said that even if DoD leaves a site, they may choose to keep the housing project going. This is because the developer will then be allowed to charge market rates, which could provide an income stream to DoD that can be used elsewhere.

Joint Basing Housing Issues

Mr. Sikes said that a big issue for them will be how to handle the housing issue under joint bases. There was no discussion on this issue before he saw it in the BRAC recommendations. DoD is currently working to develop joint base operating support standards. There is a concern on how the joint basing will affect projects that are at different stages. In addition, the Air Force, at McChord is responsible for the housing projects at two other bases (Travis and Fairchild). McChord, however, is expected to go under the Army for base operations. The question is what happens to Travis and Fairchild under this arrangement? He does not know at this point how this will affect the McCord's housing projects. The Air Force does not do Limited Liability Corporations like the Army does. Further, the Air Force has been combining sites where they make money with sites where they do not, i.e. Bolling (makes money) and Barksdale (does not make money). The services plan to meet in the next few weeks to discuss this issue.

* Denotes individual responsible for completing the memorandum.

FYI - Background - housing privatization
 USA example
 BAM

THE PROPEI

Army Looks to Sweeten Life in Oahu

Private Developer Begins Work on \$2.2 Billion Project To Refurbish, Build Homes

By MICHAEL CORKERY

The Pentagon is about halfway to what it set as a goal for building or refurbishing more than 185,000 housing units, and now the 10-year effort to raise housing standards to improve morale has started its biggest project yet. Real-estate developer Actus Lend Lease has begun work on a \$2.2-billion project to refurbish and build 185,515 homes for armed services' members and their families on the Hawaiian island of Oahu, one of nation's hottest real-estate markets.

Actus is replacing 40-year-old housing, mostly small apartment buildings, with suburban-style communities powered in part by solar energy. As part of the deal, the military is leasing its prime

property around Honolulu to a partnership called Army Hawaii Family Housing Inc., in which the army has a 49% stake and Actus Lend Lease has a 51% stake.

Actus will develop, build and manage the properties. The Army contributes no money to the project but is providing the land for free in the form of a long-term lease.

It's the largest such project since Congress first tapped the private sector to upgrade military housing in 1996. Pentagon officials figured private developers could finance and construct the new housing faster and more cheaply than the government could. Replacing outdated housing is considered critical in bolstering morale among the troops.

The Pentagon is about halfway to its goal of getting development agreements to build or refurbish 185,515 units by late September 2007. Actus Lend Lease, a subsidiary of the Lend Lease Corp. of Australia, is a leading player in the military-housing boom and has already landed some of the biggest deals, including a

\$1.2-billion project at Fort Hood, Texas, and projects at Fort Campbell, Kentucky, and Fort Drum, New York.

Actus Lend Lease is contributing just \$20 million in equity to the Hawaiian project and selling \$1.6 billion in bonds to help finance the project.

The rest of the financing comes from rental income thrown off by the current and newly renovated buildings and interest from the project funds, which will be used over 10 years. At the end of its 50-year lease of the property, the Army has the option of extending it for an additional 25 years.

In recent deals, the Army has required less equity, in part because lenders have been eager to fund the deals.

One financing team told the story better than anyone, said Donald Spigelmyer, the Army's director for its Residential Community Initiative.

Many housing projects carry some risks unique in the real-estate world. An installation could close or the number of troops there could be trimmed, leaving a

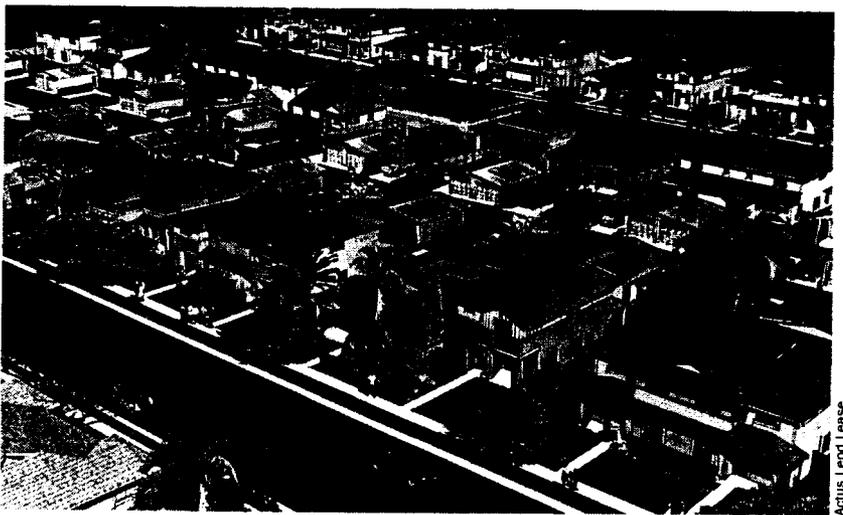
service developer with empty houses. Rent can't exceed a service member's basic allowance for housing, and there's no requirement that soldiers live on base.

Military housing is intended for enlisted service members at the bottom end of the pay scale, but Hawaii's hot housing market forces many soldiers to live on base. The military's average monthly basic housing allowance in Hawaii is higher than on most installations, about \$1,500 a month.

In the more remote locations, the military has had to entice developers with subsidies and mortgage guarantees but Hawaii, with its strategic importance and strong housing market is highly desirable for developers. "The military is going to be in Hawaii for a long time to come," said Gary Buechler, chief commercial officer at Actus Lend Lease. "It gives the financial markets comfort."

Even if the base closes, Actus can rent the units to civilians, which in Honolulu could prove more fruitful than it would be in the far-flung installations of the Midwest or the frigid reaches of northern New York.

Oahu is home to 17,000 soldiers of the 25th Infantry Division. The new Army "communities" will be located at Fort



The Army's residential Hawaii development is the largest such project since Congress first tapped the private sector to upgrade military housing in 1996. Improving outdated housing is thought to be crucial in boosting morale.

Shafter and Schofield Barracks and 17 other Army sites around the island. The project will draw 30% of its electricity from solar energy, saving on Hawaii's high energy costs.

Actus Lend Lease boasts that the project will be the largest solar-powered community in the world, dwarfing its other large green development, the Olympic Village in Sydney, Australia.