APPENDIX H
W912DR-04-R-0012
OMB SCORING GUIDANCE

1.0 SCORING DOD'S MILITARY HOUSING PRIVATIZATION INITIATIVES

A. Military Housing Privatization Initiative Authorities

The Military Housing Privatization Initiative (MHPI) provisions in Public Law 104-106 provide the Department of Defense (DOD) and the Military Services with many authorities that may be used to attract private capital investment and expertise for revitalizing and operating the stock of military housing. This statute defines the guidelines that the Office of Management and Budget (OMB) will use to determine the budgetary impact of DoD's use of these authorities.

B. Definition of OMB Scoring

OMB Scoring is defined as the quantification of a future / potential liability to the government as a result of a contractual obligation or agreement. OMB scoring, as mandated by the Credit Reform Act of 1990 and further refined in OMB Circulars A-11 and A-129, requires the government agency involved to obligate funds to cover the scoring determination prior to the closing of the contract / agreement. By obligating these funds up-front, the government is effectively setting aside, similar to an insurance premium, that amount determined to cover the down-stream liability in the event that liability occurs.

C. Scoring Determines Obligations to be Recorded

Each privatization agreement DoD enters into must be reviewed to determine if it must be scored for budget purposes. This review seeks to determine if an agreement should be scored and the cost that should be recognized and recorded as an obligation of DoD at the time that agreement is sent to the Congress for final approval prior to issuance of a Notice to Proceed (NTP). Sufficient appropriations must be available to cover the amount obligated for each agreement. The DoD, with OMB concurrence, will determine the amount of funds to be obligated to cover future costs associated with the use of the tools provided in the MHPI.

D. Direct Loans and Loan Guarantees

1. Two important financing tools available to DoD for housing revitalization efforts are direct loans and loan guarantees. Each provides a government subsidy that must be considered and accounted for in making financing decisions. The budget impact of using each of these authorities must be estimated and sufficient funds obligated to cover the estimated cost to the government. The amount of obligations to be recorded for a direct loan or loan guarantee depends on the subsidy rate. The rate represents, in net present value terms, the cost of estimated defaults (net of recoveries) and interest rate subsidy, if any, over the life of the loan or guarantee. For example, if the subsidy rate is 25 percent, obligations of $10 million would be recorded for a $40 million loan or guarantee. Before the government can enter into an agreement for a loan or guarantee, appropriations sufficient to cover the subsidy cost of each project must be available in DoD’s Family Housing Improvement Fund (FHIF).

2. The scoring for a direct loan has three components. First, the financing subsidy is derived by comparing the direct loan rate to the effective Treasury Rate computed from the “basket-of-zeros” as described below. Second, the economic risk is computed by spreading an economic risk factor over the first ten years of the loan term via a probability distribution. Lastly, the direct loan is evaluated against the base closure, downsizing and extended troop deployment probabilities and recoveries used for DoD credit authorities.

3. The scoring for a loan guarantee attempts to quantify the Government’s obligation if the loan were to default and the guarantee were to become payable at any given time during the project term. The remaining balance of the loan is evaluated against the base closure, downsizing and extended troop deployment probabilities and recoveries used for DoD credit authorities.

E. Participation Test for Direct Loans and Loan Guarantees

For both on-base and off-base revitalization projects, substantial private sector risk is necessary to conform to the provisions of the Federal Credit Reform Act. Each housing privatization project that uses a direct loan or loan guarantee must meet the following risk or "participation" test: at least 20 percent of all resources for a project must be provided from private sources without government involvement. If a project does not pass the participation test, the full amount of a loan or guarantee will be recorded as an obligation of the government. This is especially critical for on-base projects, given the inherent governmental nature of any construction and federal use of projects built on federal land. Additional information for determining government and private sector participation is included at the end of these guidelines.

F. Additional Considerations for Direct Loans and Loan Guarantees

Loans that subordinate the government's position, but have fixed repayment schedules, are scored similar to first mortgages. The credit subsidy, however, may be higher because the government is not the first creditor to be paid in case of default. A guarantee of bonds exempt from federal taxes will be recorded as an obligation equal to 100 percent of the amount of the guarantee.

G. Discount Rate for Direct Loan and Loan Guarantee Calculations

DoD should use the effective interest rate as computed by OMB's "basket-of-zeroes" discounting method. This is the rate required by the Federal Credit Reform Act to estimate the cost of credit programs for the budget. The "basket-of-zeroes" discounting method defines the present value of a series of payments as the value today of a collection of zero-coupon bonds that, at maturity, exactly match the cash flow observations.

H. Differential Lease Payments

Differential lease payments provide additional income stream to a housing provider. Use of this authority will be scored "up front", with the value of the total stream of payments under the commitment recorded as an obligation at the time a contract is finalized.

I. Income / Occupancy Guarantees

Income / occupancy guarantees are scored at 100% of the maximum exposure for the term of the guarantee.

J. Investments

If the DoD acquires part ownership of a corporation or limited partnership through the purchase of stocks, bonds, or other types of equity, an obligation will be recorded equal to the cash investment at the time a contract is finalized. That is, investments are scored at 100 percent.

K. Conveyance of Real Property

The DoD may convey property in exchange for housing or an equity investment in a corporation or limited partnership. There will be no OMB scoring impact.

L. Provision of Goods and Services

The DoD shall not provide goods or services normally paid for by a developer, homeowner, or tenant (e.g., utilities, maintenance, waste removal, pest control, snow removal, or roads for exclusive use in housing areas) as a subsidy to housing providers. When appropriate, the Department may provide goods and services, at cost, on a reimbursable basis, to housing providers or tenants.

M. Assignment of Service Members to Housing

The assignment of service members to housing on a mandatory basis is inconsistent with privatization. Moreover, mandatory assignments would reduce economic risk to the private sector and reduce incentives for private developers to build, operate and maintain quality housing. Any proposal to privatize DoD family housing should not include mandatory assignment to that housing. Mandatory assignments to housing, when combined with a loan guarantee for base closure, extended deployments, or downsizing, would effectively remove default risk and, therefore, would require the full face value of the loan to be counted as government participation.

N. OMB Review Process

OMB will work with the DoD Competitive Sourcing and Privatization (CS&P) Office prior to issuance of a Request for Qualifications (RFQ) and contract award, to review and approve/amend the Army's CS&P scoring determinations for each proposed project.

Scoring of the RFQ will involve two steps following the RFQ two-step process. In the first step of an RFQ, the Army makes a commitment to pay a fixed fee, $350,000, for the developer's plan. The fixed fee for the plan should be scored before the RFQ is issued.

OMB will review the CS&P scoring determinations as quickly as possible, especially during the period immediately preceding final submittal of the CDMP to the Congress.

2.0 INTERPRETATION OF GOVERNMENT AND PRIVATE SECTOR PARTICIPATION

The factors that CS&P and OMB will consider federal government participation for RFQs include:

a) 100 percent of any direct loan amount.
b) Issuance of a loan guarantee that protects a lender only in case of default due to base closure, extended deployment, or downsizing. Then, 10 percent of the value (varies due to risk) of a first mortgage shall be considered as government participation. The participation percentage may vary, up or down, depending on the specific conditions that would trigger payment under such a guarantee.
c) Cash investments.
d) Differential lease payments.
e) Income or occupancy guarantees.
f) Income from conveyed assets prior to renovation.

The factors that CS&P and OMB will consider private sector participation include:

a) Cash investments.
b) Value of assets other than cash (excluding assets conveyed to private sector by the federal government)
c) Portion of net income generated by new units used to fund construction and revitalization costs or capital improvements, or in the case of revitalized units, the portion of net income (after revitalization) used to fund construction and revitalization costs or capital improvements.
d) 80 percent of the value of a first mortgage if the DoD issues a loan guarantee that protects a lender only in case of default due to base closure, extended deployments, or downsizing. The participation percentage may vary, up or down, depending on the specific conditions that would trigger payment under such a guarantee.