

"PRIVATIZATION THROUGH PARTNERSHIP"

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INTRODUCTION

Thank you, Mr. Mosely, for your kind introduction, and for all of your efforts in arranging this meeting. I'm pleased to join you in your beautiful and historic city, and to share our common interest in a strong and vital United States Army.

Before I begin, I'd like to ask all of you to join me in a moment of silent prayer for our troops in the Balkans and in other areas around the world where our Army is serving courageously and selflessly. **PAUSE**

As Mr. Mosely mentioned, I was appointed to this position after 32 years in the private sector, and my mission is to apply that experience to several major challenges in the Army -- how to improve the quality-of-life of our soldiers and their families; how to introduce "best business practices" in supporting the warfighting mission; how to reduce our infrastructure and overhead costs; and how to retain and enhance posts like Fort Sam that symbolize the Nation's and the Army's heritage. So long as there is an Army, I hope there is a Fort Sam -- and I will help in every way I can to ensure that result.

One of our most important assets in meeting these challenges is you -- you in the AUSA understand the Army's importance to the Nation, you are leaders in your communities, and most of you who aren't in the Army are in the private sector. During and since World War II, the "defense industry" has been integral to the Defense Department in providing the tools and systems of warfighting. But the Army's support activities -- from housing and utilities to supplies and distribution to hundreds of other functions -- have begun only recently to tap the capital and the capabilities of American business and local enterprise in a significant, transforming manner.

In the short time we have together today, I'd like to share with you some highlights of initiatives we are beginning in the Army's Installations and Environment office to do just that. We've adopted the theme of "Privatization through Partnership" to convey the overarching aim of partnering both with American business and with dynamic organizations in the non-profit sector to help us become more efficient and more effective in our core business: the design, construction,

operations, maintenance and management of Army installations; and the conservation, compliance, clean-up, and site disposal functions that are part of our environmental stewardship responsibilities.

THE MEANING OF PRIVATIZATION

Privatization is an oft-quoted but little understood term. In fact, I find that outsourcing and privatization tend to be used synonymously in government. But they are very different. Outsourcing has been standard practice in the Army for some years, as it has in corporate America. It is the process of contracting with outside, independent organizations which can provide support services faster, better or cheaper than we can, mainly because those services are *their* core business, but they're not ours. Outsourcing does not shift the responsibility for performance or change the nature of the service. It merely changes the organization and methods of supplying or delivering the service. For example, when we outsource trash collection or publication of the garrison newsletter, we still retain the responsibility for ensuring that the service is accomplished on time and on budget -- and that it meets our service quality levels and other requirements that we have defined and agreed with the vendor.

Privatization, on the other hand, goes much deeper than outsourcing. It means shifting some or all of the responsibility for planning, organizing, financing and managing a program or activity from the Army to private contractors and partners, while retaining some interest in the operations, services and profits of the program. It may also mean transferring some or all of the ownership of Army assets, such as land, buildings and equipment, from the Army to a private entity.

The bottom line is that any military function or activity that is mirrored by a large, diverse, competitive market in the private sector is a candidate for privatization. This concept is new to the Army and to DoD as a whole, so it is especially important to clarify what we mean as we develop new doctrine and new applications in this strategic redirection of the way we do business.

In my judgement, privatization *means* partnership and can be accomplished only *through* partnership. Partnership is, by definition, a two-way street -- whether it's among individuals, within organizations, or between business and government. It is characterized by mutual interests, mutual understanding, mutual respect, and mutual responsibilities throughout the partnership's life.

Further, privatization has two components -- attracting private *capital* to help fund our programs and operations, and enlisting private *enterprise* in designing, managing and executing programs. Some of the Army's initial privatization efforts during the past few years, including utilities, family housing and land clean-up, have been driven by the principle of leveraging the Army budget with new sources of funds. But capital alone is not enough. In fact, we have recently renamed the Army's housing privatization program from "Capital Ventures Initiative", which focused on financing, to "Residential Communities Initiative", which emphasizes the end-state result we are seeking of attractive, affordable and sustainable communities for Army families that include not only housing but the amenities that most Americans enjoy in their neighborhoods and communities.

We want to leverage industry's ideas, knowledge and capabilities in community development and homebuilding, in project management, in "best business practices", in the use of

technology, and in the art and science of preparing property for reuse and redevelopment. In short, we want to benefit from what I call the "4 Es" of private enterprise -- the entrepreneurship, the energy, the efficiency and the expertise that industry can bring to a partnership with government.

Why are we focusing on privatization? Because we have to, for two reasons. First, we must reduce our vast infrastructure. We simply can't afford to carry the huge inventory of land, buildings and other facilities that we've inherited because they divert scarce resources from critical needs to modernize the force and improve our soldiers' quality-of-life. Privatization can help to create value from these illiquid real estate assets that can be redeployed for other purposes.

The second reason is specific to the Army's housing, facilities and environmental programs -- reducing the costs and leveraging the investments we make in construction, compliance, clean-up, disposal and base operations. Consider our resources. We now spend \$2.9 billion per year, or 4.6 percent of our total budget, on military construction; \$1.6 billion, or 2.5 percent, on real property maintenance; and another \$1.6 billion, or 2.5 percent, on environmental operations. For a time, the rate of increase in parts of our budget was greater than in most other major cost categories in the total Army budget. In an era of scarce resources, this alone is cause for concern because we cannot afford to shortchange the "tooth" by overspending on the "tail".

Yet we face acute problems that overshadow these budgets. We have a \$6.5 billion backlog of substandard family housing that would take 130 years to clear under current budget limits and procedures, or \$600 million a year of new funding for 10 years -- money we just don't have and simply will not get.

And while we are careful stewards of the lands and environments entrusted to us, environmental operations are not our basic mission. So we have to find innovative ways to cut the cost, contain the cost and control the cost of such support services. We have no other choice.

Other forces propel our interest, such as the Administration's Reinventing Government and National Performance Review platforms, and the Defense Reform Initiative. They call for fundamental changes in government's traditional role, with increasing reliance on the private sector to accomplish our goals. The National Defense Panel views outsourcing and privatization as key ingredients in DoD's transformation strategy over the next 20 years. And having entered government from the private sector only nine months ago, I already realize that this is a profound, but inevitable, change in the way the government does its business -- a "paradigm shift" in today's management jargon.

INCENTIVES -- THE KEYS TO PUBLIC-PRIVATE PARTNERSHIPS

To attract partners in the private sector, we must provide incentives. The firms we seek as partners -- those with the talent, the technology and the treasure we need -- will not engage with us just because we're big and we're here. But I believe that they will respond to four incentives we can offer -- and to an aggressive marketing program that shows we're serious.

The most obvious incentive is profit. There must be opportunities for real profit in every venture we seek to privatize; otherwise, it will not be a sustainable business proposition for the long-term.

With profit comes risk, so the second incentive is enabling the industry to balance the risks and rewards of partnering with us. Some of the Army's capital and operating risks can be

shifted to the private sector in return for potential profits. For example, the availability of relatively low cost environmental insurance to supplement contractor's equity and reduce risk makes the investment in land clean-up more attractive. And the provision for guarantees against base closures and major deployments in housing privatization reduces those extraordinary, uncontrollable risks for the developer.

Third, the Army offers scale, scope and sustainability to prospective industry partners. We have an enormous backlog of housing and other types of buildings to be revitalized and thousands of sites to be cleaned-up. From a business perspective, the size and diversity of our real estate portfolio enables companies to plan entry strategies in new markets for the long haul. Moreover, few organizations in the American economy can aggregate and structure programs in multi-million and multi-billion dollar packages as we can. If we do our job well, we should be able to attract many prospective partners and broaden the base of competition.

Consider land cleanup. It is not an Army core competency, yet we expect to invest \$18 billion in it over the next 20 to 30 years. This represents an enormous potential market for an industry with substantial technological and managerial competence. Indeed, privatization is the *only* means of accelerating cleanup consistent with planned investment levels to meet the Defense Planning Guidance goals for closing out sites.

Finally, we can – in fact, we must -- use innovative procurement methods, such as qualifications-based selection, performance-based contracting and incentive fee contracting. These stretch industry to use its ingenuity to find better, cheaper ways to meet our objectives, and ensure that we engage better quality partners to work with us.

THE ARMY'S INFRASTRUCTURE INITIATIVE

We're launching a series of initiatives to design, test and implement various approaches to privatization. They run the gamut of our installation and environmental responsibilities, from historic properties, family housing, and land clean-up and reuse, to utilities, energy management and environmental technology, to procurement reform. To give you a glimpse of privatization at work in the Army, here are several examples.

Privatizing Utilities

In utilities privatization – our earliest initiative -- we transfer ownership, operation and maintenance of our water, electricity and sewage treatment facilities to a private firm or special authority. So far, we have privatized 66 systems out of 1,100, and project an additional 800 systems for conversion between Fiscal Year 2001 to 2003.

A powerful tool in this is the energy performance contract in which private firms invest capital and provide energy enhancement equipment such as high efficiency boilers, heat pumps and new windows. In return, they share in cost savings from reduced energy consumption. In addition to cost savings, there are environmental benefits from lower emissions of greenhouse gases.

Preparing Army Land for Reuse

In preparing contaminated land for reuse, the Army traditionally has cleaned up properties *before* their transfer to local communities for redevelopment. We are now promoting a broad strategy that employs our early transfer authority in partnership with the private sector.

At one Army plant, a private developer wants our property to develop an entertainment theme park. The developer has proposed to conduct the cleanup in exchange for receiving credit

against the property's purchase price, using an early transfer authority. If this arrangement can be negotiated, the Army will not have to invest additional funds in cleanup. By taking risks, the developer stands to profit. A major incentive for the developer is tax exempt financing. This would be a win-win situation for both the Army and the developer.

The Army's Historic Properties Initiative

Close to home for you, we are addressing the challenge of preserving and enhancing our historic posts and properties like Fort Sam by selective but proactive privatization.

The Army has the Nation's largest portfolio of historic properties by far -- some 12,000 historic buildings; 12 of our posts, including Fort Sam, are National Historic landmarks; and we face the prospect that 70,000 more buildings may be determined eligible for the National Register of Historic Places in the next 30 years.

The scale and diversity of this portfolio is a daunting challenge to all of us involved in the Army's installation management. But it also presents an extraordinary opportunity for creative ways to re-use old buildings and to recapitalize our real estate.

Fort Sam -- with over 900 historic buildings -- has one of our largest concentrations of historic properties, and an exemplary Historic Property Management program. Successive command teams have done a comprehensive inventory of historic buildings and have a solid compliance history with the National Historic Preservation Act.

The efforts of the Command, the Director of Public Works and the staff historic architect have enhanced the post noticeably. The Post Exchange and Commissary are sympathetic to the Spanish architecture of Fort Sam. A historic landscape plan provides texture, visual enhancements and drought resistant plantings. The design of a visitor information kiosk in the Quadrangle echoes a former hitching post documented by historic photographs.

Partnerships have played a significant role in the reuse of notable buildings. The historic band barracks, partially destroyed by fire, was rehabilitated through a partnership between the Army and the National Park Service's training program for the maintenance and repair of historic buildings. The building has now been returned to its original function as the home of the Fort Sam Houston band.

The Stillwell House, a former family housing unit, has been rehabilitated through the excellent work of the Friends of Historic Fort Sam Houston which restored the home through a unique arrangement where the rehabilitation work was a gift to the Army, and have made it available for both installation and community functions.

These innovative approaches to design, construction and operations result in compatible buildings that truly complement the historic nature of this post. And they are the types of actions that I envision for the rest of the Army. But to extend them both at Fort Sam and elsewhere, we have to change the way we manage historic properties. So we are forming an Office of Historic Properties to provide a focus for action, facilitate awareness, address the tough real estate and economic opportunities and constraints that we face with hard business analysis, and test innovations in how we do business in various locations.

We will be analyzing the rules associated with budgeting, leasing and renovating properties with a goal of "preservation and privatization through partnership", and evaluating the potential for an Army Historic Properties Trust to recapitalize these special properties and to provide needed funds for preservation. We have established Cooperative Agreements with the

President's Advisory Council on Historic Preservation and the National Trust for Historic Preservation. As our program matures, we will be seeking public and private sector partners to address specific preservation needs, such as the rehabilitation of notable buildings, such as BAMSI, and the privatization and preservation of historic family housing units.

Reforming the Procurement Process

As we pursue partnerships to preserve and privatize the real estate, we have to make it easier and cheaper for the private sector to partner with us. So I have also pressed with great urgency to streamline the procurement process. We have developed a Request for Qualifications, known as an RFQ, in which the Army defines the qualifications for selecting the partner instead of detailing our plan for the project. Qualifications include the business vision for the project, demonstrated experience, financial resources and management capabilities. Once the partner is selected, we will jointly prepare the project development and management plan. The plan will set forth the terms of the partner's relationship with the government over the life of each project. This contrasts markedly with the traditional Request for Proposals process which forecloses the private firm from applying its ingenuity in creating the project before the bid is completed.

CONCLUSION

I hope these examples will stimulate your interest and your ideas. And in closing, I leave you with this message: the Army is pursuing privatization with vision and vigor. We want to partner with the private sector, harnessing its entrepreneurship, its experience, its energy and its efficiencies wherever we can. These must be true partnerships, recognizing the benefits that derive from a balanced relationship with shared goals and expectations.

We are looking for successful models within the Army, elsewhere in DoD and the federal government, and in state and local government as well. We are also meeting with business executives to learn more about how they are managing public-private partnerships. As you leave today's meeting, I hope you will think about our theme -- "privatization through partnership" -- and about opportunities to serve the Army through public-private partnerships.

Thank you again, Mr. Mosely, for inviting me to join you today.

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To develop and promote an overall privatization strategy, I have set up various task forces to identify and test pilot demonstration projects.

The Residential Communities Initiative

The Army's housing privatization program is a major Administration priority, and it is one of the main reasons I was asked to take this office.

As I mentioned earlier, the Army has an acute family housing problem That we must solve to contract and retain soldiers and their families. I consider this basic institutional responsibility as my most important professional and personal challenge, and I have pressed forward with great urgency in the past eight months to design and test an Army housing privatization program. I am pleased to report that the industry has shown great interest in the program, and the Army leadership has expressed its support.

Our overriding goal is to enhance the quality of life for soldiers and their families by creating and sustaining attractive, affordable residential communities on Army Posts. The Army's Residential Communities Initiative is designed to maximize the Army's advantage of scale and use the privatization tools Congress has given us to attract the world's most effective homebuilding and real estate industry in housing the world's best Army in the quality communities they deserve.

As part of our pilot program, we are pursuing three changes in policy and practices. First, our management focus is shifting from *housing production* to *community development*. Each project will include the features and amenities that most Americans enjoy in their neighborhoods, such as extensive landscaping, community centers, recreation facilities, and ongoing maintenance of public space, as well as housing renovation and construction. The second change is transforming our business relationships from *contracting* to *partnering*, in which the developer will arrange the project financing from private investors, take the business risks, hire and manage the contractors, and provide ongoing services with specific performance measures that align the developer's goals with the Army's.

Managing a Remediation Partnership -- The Army's Rocky Mountain Arsenal

The Army's Rocky Mountain Arsenal, or ARMA, near Denver, is a superb illustration of privatization through partnership. The Army, the US Fish and Wildlife Service and Shell Oil Company created a unique partnership called the Remediation Venture Office (or RVO) to accomplish DoD's largest clean-up effort. Secretary of Defense William Cohen visited ARMA last June, and declared it a "national model."

A contractor manages over 36 separate projects. Contracting with a single firm to manage the entire cleanup has increased efficiency in three ways -- by ensuring that personnel with the appropriate job skills are matched to the task, by compressing the cleanup timetable considerably, and by reducing the cost of cleanup.

The contract fosters a true Government-Industry partnership. It is a blend of "Time and Materials" and "Cost plus Award Fee" contract types, and is predicated on a "pay for performance" concept; all money set aside in the fee pool is at risk and subject to the government's assessment of performance. The prime contractor does not directly perform the cleanup, but designs the projects and manages a cadre of sub-contractors, with responsibility for ensuring that the Army meets the cleanup schedule and stays within cost guidelines.

We have achieved remarkable success in the first year of the contract that translates into dollars to be applied elsewhere in the Army budget. The key success factor is that the Remediation Venture Office and contractor staffs complement each other; each organization leverages the strengths to achieve success; and they have a shared vision of the future of ARMA as the nation's largest urban wildlife refuge.

Applying Environmental Science and Technology

Environmental science and technology open other prime opportunities for industry partnerships. In bio-remediation, for example, the Army is remediating contaminated soils at several ammunition plants through composting, using naturally occurring microorganisms to degrade organic wastes. We partnered with industry to conduct the bench-scale and full-scale tests. The results showed 99 percent destruction efficiency of explosive compounds. The modest equipment and monitoring requirements makes composting a cost-effective technology. The technology has been used at several locations at costs many times lower than conventional incineration techniques.

Similarly, phyto-remediation uses plants which can absorb contaminants from soil and ground water. The Army is working with the Tennessee Valley Authority and a firm that specializes in phyto-remediation to take this technology to the field. Studies have shown surprising results: phyto-remediation can remove lead and explosives residues at a lower cost than excavation and landfill. It also minimizes site disturbance and can eliminate long-term monitoring requirements.

Composting technology is also helping the Army to contain the spread of plastic pollution. Nearly 40 billion pieces of disposable tableware and 113 billion plastic cups are used annually in the US, and the EPA estimates that plastic takes up 24 percent of available space in a landfill. Biodegradable cutlery, trash bags and other "bio- based" products are being tested to comply with the President's Executive Order 13101. They result in complete organic composting, 50 percent lower collection and tipping fees, and reduced landfill.

2. Redefining the doctrine of historic military properties from a cultural program to a mainstream policy. While historic buildings are sometimes important solely because they are historic, more often they serve a basic purpose in the mission and functions of the installation, as headquarters and administrative buildings, family housing, barracks, clubs and other facilities and they are major tools in strengthening Army heritage, and maintaining attractive Army posts and communities. Historic buildings *are* mainstream assets in executing elements of our mission.

3. Driving historic property decisions by economic fundamentals instead of accounting rules. Budget procedures focus on annual costs and benefits instead of lifecycle costs and long-term benefits. The rules also ignore potential economic values that can be created in real estate. Intangibles, such as the positive impact of attractive home and work environments, and the sense of Army history and discipline provided by the built environment, also are given short shrift, even when private market evidence in support of these benefits is compelling. Initial renovation costs tend to be higher even when their long-term operating and maintenance costs are comparable or lower.