Reason Foundation
February 2011

Annual Privatization Report 2010: Federal Government Privatization

By Adam Summers and Anthony Randazzo
Edited by Leonard Gilroy

Reason Foundation

Reason Foundation's mission is to advance a free society by developing, applying and promoting libertarian principles, including individual liberty, free markets and the rule of law. We use journalism and public policy research to influence the frameworks and actions of policymakers, journalists and opinion leaders.

Reason Foundation's nonpartisan public policy research promotes choice, competition and a dynamic market economy as the foundation for human dignity and progress. Reason produces rigorous, peer-reviewed research and directly engages the policy process, seeking strategies that emphasize cooperation, flexibility, local knowledge and results. Through practical and innovative approaches to complex problems, Reason seeks to change the way people think about issues, and promote policies that allow and encourage individuals and voluntary institutions to flourish.

Reason Foundation is a tax-exempt research and education organization as defined under IRS code 501(c)(3). Reason Foundation is supported by voluntary contributions from individuals, foundations and corporations.

Copyright © 2011 Reason Foundation. All rights reserved.

Reason Foundation

Annual Privatization Report 2010: Federal Government Privatization

By Adam Summers and Anthony Randazzo
Edited by Leonard Gilroy

This is an excerpt from Reason's *Annual Privatization Report 2010*, which is available online at http://reason.org/apr2010

Table of Contents

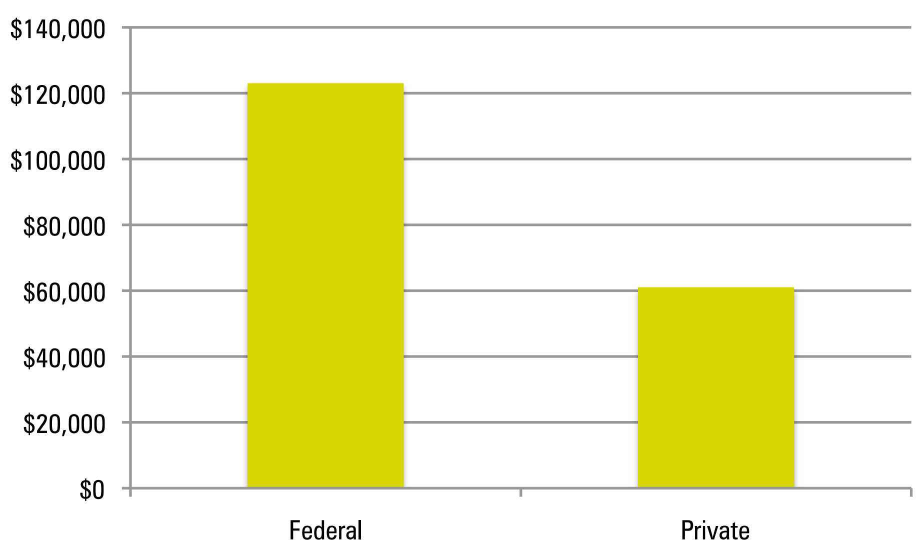
Part 1

Federal Worker Compensation Far Exceeds Private Sector Compensation

It has long been argued that government workers must receive greater job security and benefits than private sector workers because government jobs yield lower salaries than those in the private sector. Yet government data increasingly and repeatedly reveal that public sector workers oftentimes receive *higher* salaries than their private sector counterparts, on top of the significantly greater benefits and job security they enjoy.

Over the past year, *USA Today* has done a series of analyses of government data illustrating the significant gap in pay and benefits between federal government workers and their private sector counterparts. Using data from the U.S. Bureau of Economic Analysis (BEA), the newspaper reported in August 2010 that federal civil servants earned average pay and benefits of $123,049 in 2009, twice as much as the $61,051 earned by private workers (see Figure 1).

Figure 1: Average Federal Government and Private Worker Pay, 2009



Source: U.S. Bureau of Economic Analysis, *USA Today* analysis

Moreover, the compensation gap between the public and private sectors has been growing. Federal workers have received larger average pay and benefit increases than private employees for nine years in a row and the compensation gap has doubled in just the last decade. Since 2000, total federal compensation has grown 36.9% after adjusting for inflation, compared with 8.8% for private workers.

The situation is similar for state and local government workers. According to the most recent Employer Costs for Employee Compensation Survey from the U.S. Bureau of Labor Statistics (BLS), as of June 2010, state and local government employees averaged $39.74 an hour in wages and benefits, about 44% more than the $27.64 an hour average for the private sector. That includes 34% higher wages and 68% greater benefits than private sector workers.

Labor unions have criticized the use of such data, and correctly note that the use of averages can be misleading or inaccurate due to the different nature of many jobs in the public and private sectors or the fact that the private sector is comprised of more low-paying service industry jobs that drive down average compensation. Yet, another *USA Today* analysis of BLS data in March 2010 examined compensation rates for 216 occupations that exist in both the federal government and the private sector and found that federal salaries were significantly higher in five out of every six occupations.

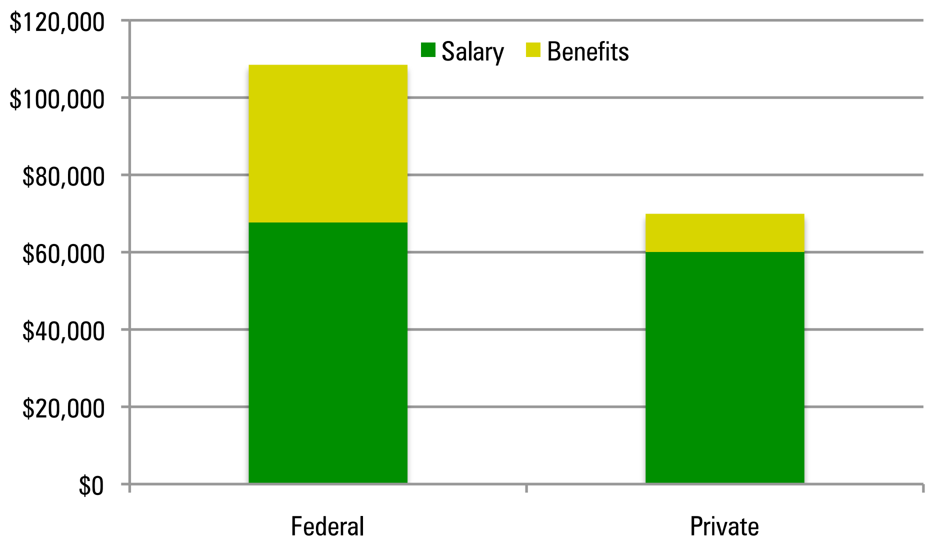
> *Accountants, nurses, chemists, surveyors, cooks, clerks and janitors are among the wide range of jobs that get paid more on average in the federal government than in the private sector. [. . .]*
>
> *The federal pay premium cut across all job categories—white-collar, blue-collar, management, professional, technical and low-skill. In all, 180 jobs paid better average salaries in the federal government; 36 paid better in the private sector.*
>
> *The private sector paid more on average in a select group of high-skill occupations, including lawyers, veterinarians and airline pilots. The government's 5,200 computer research scientists made an average of $95,190, about $10,000 less than the average in the corporate world.*

Overall, federal government employees earned an average salary of $67,691 in 2008 for occupations that exist in both the public and private sectors. Private workers averaged $60,046 for the same mix of jobs.

The difference in benefits was even more substantial. According to the BEA, the value of federal workers' health, pension and other benefits averaged $40,785 in 2008, compared with $9,882 per private worker.

Adding the average salaries and benefits together yields total compensation of $108,476 for federal government employees versus $69,928 for private workers. This means that federal workers earned 55% more than private workers for the same occupations (see Figure 2).

Figure 2: Average Salary and Benefits, Federal Government Workers vs. Private Workers, 2008

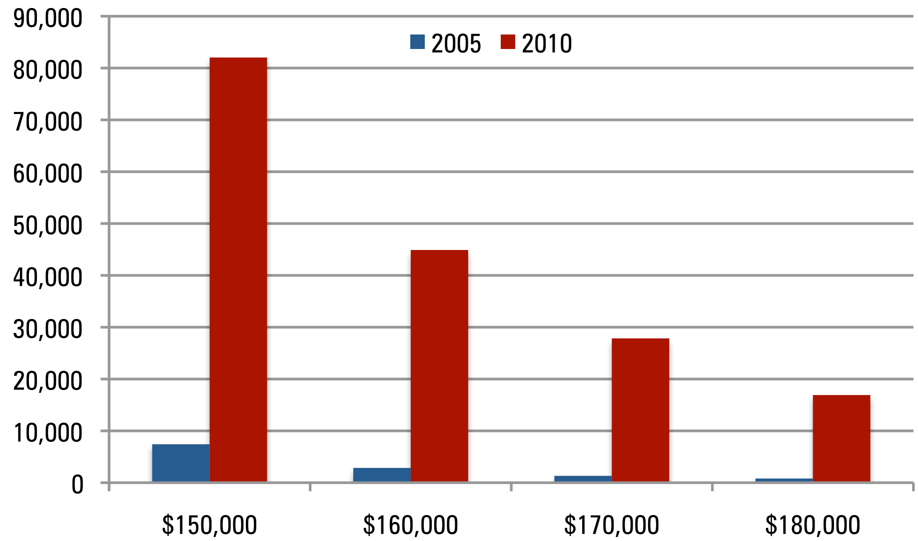


Source: U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Analysis, *USA Today* analysis

Furthermore, even these compensation comparisons ignore the value of government employees' ironclad job security, which is not available in the private sector, and the fact that private sector employees work longer hours, on average, than government workers.

Such reports have received a growing amount of public attention as anger and frustration among taxpayers over the federal government's large deficits and stimulus programs mounts. A third *USA Today* analysis added fuel to that fire in November 2010 when it was revealed that, according to U.S. Office of Personnel Management data, the number of federal workers earning salaries of $150,000 a year or more has increased elevenfold in the past five years, and doubled just since President Obama took office nearly two years ago. In 2005, 7,420 federal workers earned at least $150,000 a year; today 82,034 federal workers make that much. The number of federal workers earning at least $180,000 a year has skyrocketed from 805 in 2005 to 16,912 in 2010 (see Figure 3).

Figure 3: Number of Federal Government Employees Earning High Salaries, 2005 vs. 2010



Source: U.S. Office of Personnel Management, *USA Today* analysis

Revelations such as this have prompted Republican lawmakers to call for reductions, or at least a freeze, in federal worker pay. Rep. Jason Chaffetz (R–UT), who will head the panel overseeing federal pay, said he wants a pay freeze, although he would prefer a 10%, across-the-board cut. “It’s stunning when you see what’s happened to federal compensation,” Chaffetz remarked in the November 2010 *USA Today* article. “Every metric shows we’re heading in the wrong direction.”

In November 2010, President Obama acceded to the calls to control federal pay, proposing a two-year freeze on the salaries of civilian federal employees. If adopted, the measure is expected to save $2 billion in the current 2011 fiscal year, $28 billion over the next five years, and more than $60 billion over 10 years. “The hard truth is that getting this deficit under control is going to require some broad sacrifice, and that sacrifice must be shared by the employees of the federal government,” Obama said in a press conference announcing the pay freeze.

Even these savings are but a drop in the bucket for a budget deficit that is currently $1.3 trillion and is projected to exceed $1 trillion a year for the foreseeable future. As governments at all levels continue to struggle with sizeable budget deficits, the growing gap between government and private worker compensation is sure to be an increasingly considerable—and contentious—issue for years to come.

Part 2

Fight over Insourcing Initiative Dominates Federal Contracting Policy

Most people are familiar with the term "outsourcing," referring to contracting out work to another party, such as when the government contracts with a private sector firm to provide goods or services. Under the Obama administration, people are becoming more accustomed to hearing about the opposite process, "insourcing," whereby the government brings previously contracted services back "in-house" to be performed by government employees. There has been a decided push within the Administration to limit government contracting and increase the number of activities performed by government employees.

The first step in the Administration's insourcing initiative was narrowing the scope of which activities may be contracted out to the private sector. According to the Federal Activities Inventory Reform (FAIR) Act, government activities are classified as either "inherently governmental" or "commercial in nature." Inherently governmental activities are defined as those functions "so intimately related to the public interest as to require performance by Federal Government employees," while commercial activities are those routinely performed by private sector companies.

Yet, in a proposed Office of Federal Procurement Policy letter issued in the spring of 2010, the Administration sought to add a third category to cover a new class of functions—those "closely associated with the performance of inherently governmental functions"—which would also be reserved only for government employees. The effect of this new category is to blur the lines between "inherently governmental" and "commercial" functions and reduce the scope of services that may be contracted out, thereby increasing the federal workforce. Language included in the Financial Service and General Government Appropriations Act, 2011 (S. 3677) would codify the "closely associated with inherently governmental functions" policy. The Senate Appropriations Committee recommended that the bill be considered by the full Senate and the legislation was placed on the Senate calendar in late July 2010. No further action had been taken on it as of this writing.

This would mark a significant departure from federal procurement policy over the past 55 years, as well as from Thomas Jefferson's assertion in 1808 that "It is better for the public to procure at the market whatever the market can supply; because there it is by competition kept up in its quality, and reduced to its minimum price."

Business interests and a number of Republican politicians countered the Administration's insourcing efforts by putting forth legislation that would prohibit the government from engaging in unfair competition with its own citizens (i.e., private sector providers) to provide services and would encourage the government to contract with private sector businesses to provide goods and services. Under the Freedom from Government Competition Act (H.R. 2682 in the House; S. 1167 in the Senate), federal government agencies would be required to contract with the private sector for goods and services except in cases where:

> *(1) the goods or services are required by law to be produced or performed, respectively, by the agency; or*
> *(2) the head of the agency determines and certifies to Congress in accordance with regulations promulgated by the Director of the Office of Management and Budget that*
>> *(A) Federal Government production, manufacture, or provision of a good or service is necessary for the national defense or homeland security;*
>> *(B) a good or service is so inherently governmental in nature that it is in the public interest to require production or performance, respectively, by Government employees; or*
>> *(C) there is no private source capable of providing the good or service.*

Both bills were stalled in committee, but they may receive renewed attention from the new Congress since the Republicans took control of the House of Representatives and posted gains in the Senate.

There has been some pushback on the insourcing initiative even within the Administration, however. In August 2010, Defense Secretary Robert Gates announced that the Pentagon was abandoning its insourcing efforts because it had not achieved the projected savings. In 2009 the Department of Defense revealed that it would reduce the number of its service support contractors by about 33,000 by 2015. Those contractors were to be replaced with 39,000 new full-time government employees. But, according to Gates, "As we were reducing contractors, we weren't seeing the savings we had hoped from insourcing."

The department had intended to insource contracted services in areas such as logistical support of aviation systems, safety engineering, cost accounting, anti-terrorism training and religious support. Instead, Gates' plan calls for a $100 billion reduction in spending over five years by eliminating thousands of both DoD and contractor positions, including a 10% reduction in spending on service support contractors for each of the next three years. So far, the civilian agencies have not followed the DoD's lead, however, and continue to implement their insourcing programs.

Republicans in Congress have shown a good deal of resistance to the Administration's insourcing programs. With a new Republican majority in the House and a stronger Republican presence in the Senate, this opposition is likely to grow in the new Congress. It remains unclear whether insourcing opponents within and outside of Congress will be able to stem or reverse the Administration's efforts, however.

Part 3

Space, the Private Frontier?

With the aging space shuttle fleet being retired and the National Aeronautic and Space Administration (NASA) facing tight budgets, the Obama administration announced in 2009 that it was cancelling President George W. Bush's planned mission to return to the moon, and that the government would be turning to the private sector for the transportation of astronauts and cargo to and from the International Space Station. The plan also extends the space station's life by five years.

A. Private Transport of Astronauts and Cargo

Congress approved legislation ratifying Obama's strategy to use private carriers to deliver people and cargo to near-Earth space in September 2010. The move "unleashes the level of innovation in American industry, instead of keeping it all within the very tight and bureaucratic structure of a government program," according to New Mexico Spaceport Authority Director Rick Homans in an October 2010 *Las Cruces Sun-News* article.

PayPal and Tesla co-founder Elon Musk's Space Exploration Technologies Corp., known as SpaceX, developed its Falcon 9 rocket to handle these space transportation needs, and hopes to begin shuttling astronauts by the end of 2013. The company estimates that it will charge NASA about $20 million per astronaut for the voyage, a bargain compared to the $300 million per astronaut it would cost NASA, or even the $56 million a head on Russia's Soyuz rockets in the near term after the shuttle fleet is retired. SpaceX completed a successful test launch of the Falcon 9 from the Kennedy Space Center in Cape Canaveral, Florida in June 2010.

Another successful test flight in December 2010 earned the Falcon 9 the distinction of being the first privately owned ship ever to return safely from Earth orbit. Speaking of the differences between traditional government funding of the space program and the newer public-private financing model, SpaceX President Gwynne Shotwell told ABC News in December 2010, "If we overrun this program, we have to come up with the money through investment to cover the cost, which is dramatically different from contracts where if the contractor overruns, taxpayers have to pay the overruns."

SpaceX is not the only private company seeking to provide space transportation services. Other firms competing for government space contracts include Orbital Sciences, Virgin Galactic, Alliant Techsystems Inc., EADS Astrium, XCOR Aerospace, Rocketplane Limited, Space Adventures, Blue Origin, Masten Space Systems, Armadillo Aerospace, Sierra Nevada Corp., and United Launch Alliance, a joint venture between Boeing and Lockheed Martin.

B. Private Space Tourism

Space transportation is not just for the government anymore, either. The private sector is also beginning to develop a space tourism market for private consumers. Leading the way is Virgin Galactic, which is already taking reservations for commercial space flights. The trips cost $200,000 and will last two and a half hours, including five minutes of weightlessness. According to the company, some 380 customers have already put down deposits totaling more than $50 million to take the trip. Virgin Galactic expects to begin commercial operations sometime between the summer of 2011 and the spring of 2012.

Virgin Galactic's spacecraft, SpaceShipTwo, designed and built in partnership with Mojave, California-based Scaled Composites, achieved its first solo glide flight after being carried to an altitude of 45,000 feet by its jet-powered mothership, WhiteKnightTwo, in October 2010. The "flight marks another key milestone towards opening the space frontier for private individuals, researchers, and explorers," said John Gedmark, executive director of the Commercial Spaceflight Federation. SpaceShipTwo was built by famed aircraft designer Burt Rutan based on a prototype (SpaceShipOne) that won the $10 million Ansari X Prize in 2004 for being the first manned private rocket to reach space.

In addition to its suborbital trips for space tourists, Virgin Galactic announced in December 2010 that it was partnering with Orbital Sciences and Sierra Nevada Corp. in separate bids for NASA's $200 million Commercial Crew Development program for orbital flights to carry U.S. astronauts to the International Space Station. The companies' designs "could revolutionize orbital space flight in much the same way that SpaceShipTwo has revolutionized suborbital space flight," Virgin said at the time in a statement. NASA is expected to announce two or more projects for funding by March 2011.

Less than two weeks after the SpaceShipTwo test flight, Spaceport America, the world's first spaceport specifically designed for commercial purposes, celebrated the completion of a nearly two-mile long concrete runway. The taxpayer-funded spaceport is located in the New Mexico desert approximately 45 miles north of Las Cruces. Virgin Galactic will be the anchor tenant of the spaceport, and state officials hope to add other companies interested in space research and payload delivery.

In the future, the spaceport may see competition from other facilities, such as the Mojave Air and Space Port in Mojave, California. The Mojave facility, which offers a general-use public airport, civilian test flight center, space industry development and aircraft heavy maintenance and storage, became the nation's first inland spaceport when it received its spaceport operator's license from the Federal Aviation Administration in 2004.

C. Privatization of Kennedy Space Center Visitor Complex

Even NASA's Kennedy Space Center Visitor Complex has benefited from privatization. Operation of the complex was privatized in 1995 due to concerns about tight budgets and deteriorating facilities. The visitor center, which receives about 1.5 million visitors per year, has been operated for the past 15 years by Delaware North Companies Parks & Resorts. The facility is self-sustaining, meaning no tax dollars are spent maintaining or operating the complex.

As *Florida Today* space beat writer John Kelly explained in a February 2010 article, the improvements made under the stewardship of Delaware North have been significant. Despite some initial resistance to privatization from locals, particularly space workers and retirees,

> *Over the years, complaints subsided. I can't remember the last time I got one. I can't be sure why, but I suspect it's partly because people realize NASA's decision to privatize the visitor center improved its quality and guaranteed its very survival.*
>
> *The Visitor Complex used to be free, but you got what you paid for. The privatization provided a way for millions of dollars worth of investments [to be tapped and utilized to improve what had been] a deteriorating facility. In tight budget times, under government operation, it could have gotten worse or been closed.*
>
> *Under the management of Delaware North Companies the past 15 years, the complex has transformed itself into an extraordinary attraction unlike any other experience. No NASA center has a visitor complex like this one.*
>
> *The privatization of the tourist complex has provided for major improvements that would never have been possible if NASA had to run it using taxpayer money.*

In addition to the financial rescue, Delaware North remodeled and reopened the once-troubled Astronaut Hall of Fame, added the multi-million dollar Shuttle Launch Experience simulator ride, improved security, refurbished displays, and introduced more up-close, behind-the-scenes tours.

Based on Delaware North's track record at the facility, NASA announced in February 2010 that the company had won a contract to continue managing and operating the visitor center for the next 10 years, with options for an additional 10 years, depending on the firm's performance. Under the terms of the new contract, the company will relocate the Astronaut Hall of Fame, currently about eight miles away, onto the main visitor center complex grounds. This may become part of a larger museum in the mold of an interactive science center. NASA also wants the company to prepare for the display of one of the space shuttle orbiters, should the facility procure one after the shuttle fleet is retired.

Whether transporting people and cargo to the space station, offering private individuals the chance to experience suborbital space flight, or providing millions of visitors a better experience and opportunity to learn about the nation's space history and exploration, the private sector's role in space research and travel, once considered untenable, has become ubiquitous. As this trend continues and the private space industry expands, we can expect more services and opportunities for consumers and greater efficiency for the nation's space program, allowing the government to focus on its more core functions.

Part 4

Policy Spotlight: Privatizing the Housing Finance System

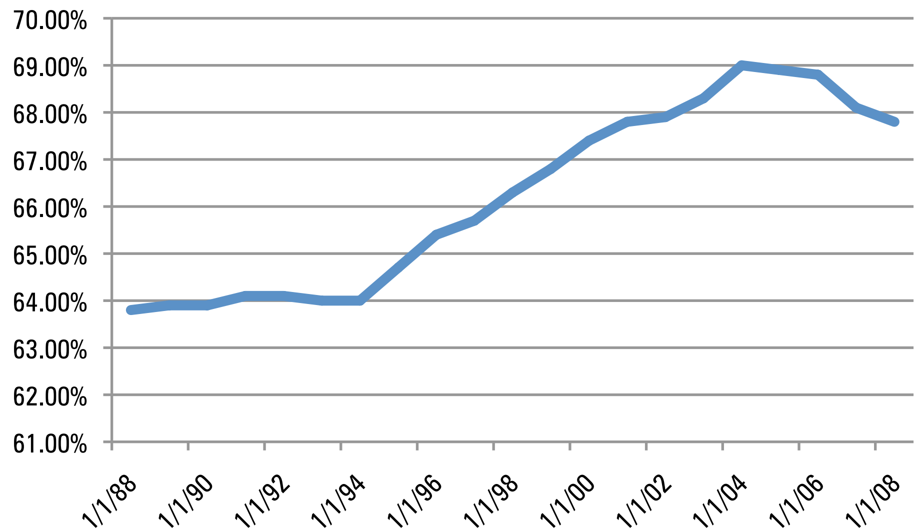
Since the credit crunch began in 2007, private sector financing for residential mortgages has been virtually non-existent. At the end of 2010, government-backed organizations—including Fannie Mae, Freddie Mac and the Federal Housing Administration (FHA)—were financing more than 90% of all mortgages in the U.S. In addition, the federal government has been using both fiscal policy and monetary policy to increase liquidity for home purchases, put downward pressure on mortgage interest rates and boost housing values. However, the various federal programs have only served to provide temporary relief from falling housing prices, delaying the necessary clearing of surplus homes in the marketplace. The programs of the past three years have continued decades of federal housing policy that ultimately created a very unstable market.

There is widespread consensus that the current system is unsustainable. Even long-time supporters of Fannie Mae and Freddie Mac, such as Rep. Barney Frank (D-MA) have conceded that the government-sponsored enterprises (GSE) need to be dissolved. However, there is a growing argument from a range of "interest" groups proposing that federal intervention and guarantees of some kind are necessary for the future of housing finance. This is far from true. Prior interventions and guarantees have a checkered past that leaves no doubt that such proposals will once again privatize gains and leave the taxpayers with the losses. The most logical path forward to a sustainable housing market is a complete privatization of the housing finance system.

A. The Last Two Decades of Housing Policy in Brief

It has long been the common belief in Washington that promoting homeownership is good politics. The chartering of Fannie Mae in 1938 and the passage of the Community Reinvestment Act of 1977 (CRA) were both designed to provide liquidity and incentives for mortgage lending. And from the 1960s to the mid 1990s, the homeownership rate stayed in a relatively stable range of 62% to 64%. Housing policy took on a new form, though, under the guidance of Housing and Urban Development (HUD) Secretaries Henry Cisernos (1993 to 1997) and Andrew Cuomo (1997 to 2001). The result of their policies, which were continued with gusto by the Bush administration, was a radical jump in the homeownership rate from 64% to 69% between 1995 and 2005, the peak of the boom (see Figure 4).

Figure 4: U.S. Homeownership Rate from 1988 to 2008



Source: U.S. Census Bureau

This may sound like a positive outcome, but the rapid growth in homeownership would prove unsustainable and has ultimately led to the foreclosure epidemic currently besetting the housing market.

One of the first major changes to promote this growth in homeownership was the Affordable Housing Initiative in the early 90s, setting out the goal of making alternative mortgage financing more readily available to low-income families. As a part of implementing the Affordable Housing Initiative, Congress passed a bill that completely updated the Community Reinvestment Act, placing more emphasis on performance-based evaluations that allowed regulators to essentially blackmail certain banks into lending (often described as "quantifiable outcomes").

In order for the banks under CRA to comply with new regulatory requirements they designed innovative lending options, such as interest-only mortgages, principal-only mortgages, and an array of adjustable-rate mortgages. Even the banks that weren't regulated by CRA developed the same products in order to compete. Quickly, borrowers with unstable credit began to find it easier and easier to obtain a mortgage. The result was a greater proportion of the population entering the housing market than was previously possible or than would have been anticipated based on normal economic and population growth trends. And with that increase came a substantial rise in prices.

While the CRA was decreasing lending standards for certain banks in the private sector, HUD directed Fannie Mae and Freddie Mac to lower their lending standards as well. As a part of the Affordable Housing Initiative, HUD Secretary Cisernos began increasing the affordable housing mandates for Fannie and Freddie. At that time, the GSEs were required to have 30% of their loan purchases contain mortgages issued to individuals or families under the median income in their area. In 1996 this quota was increased to 40%. In 1997, Secretary Cuomo increased the number to 42%, and then to 50% by 2001. According to George Mason University economist Russ Roberts, under the Bush administration HUD continued increasing the affordable housing goal of the GSEs up to 52% in 2005 and 53% in 2006. By the time the housing bubble was beginning to pop in 2006, Fannie and Freddie were required by HUD to have 55% of the loans they bought be mortgages issued to low-income borrowers.

Since their inceptions, Fannie Mae and Freddie Mac have had specific guidelines as to what kind of mortgages they can buy from the private sector. Specific aspects of a loan's down payment percentage, borrower credit history and other measurements determined whether a mortgage "conformed" to GSE standards. However, in order to meet the HUD affordable housing requirements, Fannie and Freddie had to lower their conforming loan standards. This meant the quality of mortgages on the government-sponsored enterprises' books dramatically decreased at the same time that the growth of the housing bubble increased the number and dollar amount of mortgages they took on.

As Fannie and Freddie decreased their conforming loan standards, it created a market for mortgages with increasingly higher loan-to-value (LTV) ratios. Prior to the HUD rule changes and CRA update, a minimum loan-to-value (LTV) ratio of 80% at the time of the origination of the mortgage was typical. This meant that at the time of purchase, a homebuyer was putting up 20% of the home price as a down payment and borrowing the remainder. But as seen in Table 1, loan-to-value ratios jumped an overall rate of seven percentage points during the housing bubble. LTV rates on second mortgages grew even faster. (Second mortgages, or second liens, are essentially loans taken sometime after an initial mortgage—often coming in the form of a home equity line of credit—that hold secondary priority in the event of foreclosure. Whoever holds the first mortgage has the right to be paid back in full from any recovered funds in a foreclosure proceeding, with whatever remains to cover repayment to the lender of the second lien.)

Table 1: Characteristics of Subprime Loan Originations

Year of Origination	Cumulative LTV	Silent 2nd Lien
1999	78.8	0.5
2000	79.5	1.3
2001	80.3	2.8
2002	80.7	2.9
2003	82.4	7.3
2004	83.9	15.8
2005	85.3	24.6
2006	85.5	27.5

Source: Federal Reserve Bank of New York

With Fannie Mae and Freddie Mac expanding their low quality mortgage purchases to meet affordable housing goals, the banks stepped up to meet the demand. Banks found that they could originate mortgages with high LTV ratios to borrowers with lower creditworthiness and borrowers who had limited credit histories—a.k.a. subprime mortgages—and simply sell the risk to the GSEs seeking to meet their goals. This allowed banks to offer mortgages with lower interest rates, spurring demand from buyers. That demand drove up prices, requiring the GSEs to pump more liquidity into the marketplace to push down mortgage prices to affordable levels, which simply began the cycle again.

The whole system exploded at such a rapid pace that banks forgot the housing market could not grow forever. The originators collected high fees for issuing the subprime debt, but didn't have to deal with the risk of a default. Laws that allowed for banks to operate with more regulatory freedom failed to add incentives for risk takers to watch their actions, leading to the too-big-to-fail moral hazard mentality. Lenders wheeled and dealed at such a frantic pace that banks are now struggling to find all the paperwork associated with their toxic loans as foreclosures have flooded Wall Street. But by the time the music stopped there were 27 million subprime and Alt-A mortgages in bank portfolios and securitized for investors. And of these low-quality mortgages about 71% were supported by the GSEs, FHA, CRA banks and others with government backing.

B. Post-Bubble Policies Continue the Trend

The credit crunch of 2007 threatened homebuyers with extremely high mortgage rates, given the lack of money available for lending. Many subprime borrowers with teaser rates needed to refinance every few years to avoid having their mortgages reset at high, unaffordable rates. As the credit crunch cut off refinancing opportunities it turned into the subprime foreclosure crisis. And this posed a significant problem for the government's homeownership policies. As Treasury Secretary Henry Paulson said in a July 2008 speech, "Turning the corner on the housing correction requires homebuyers to return to the market, and homebuyers need available and affordable mortgage financing." Even though by then it was clear Fannie Mae and Freddie Mac had played a substantial role in flooding the market with toxic mortgages, Secretary Paulson also argued, "The GSEs are providing an essential function."

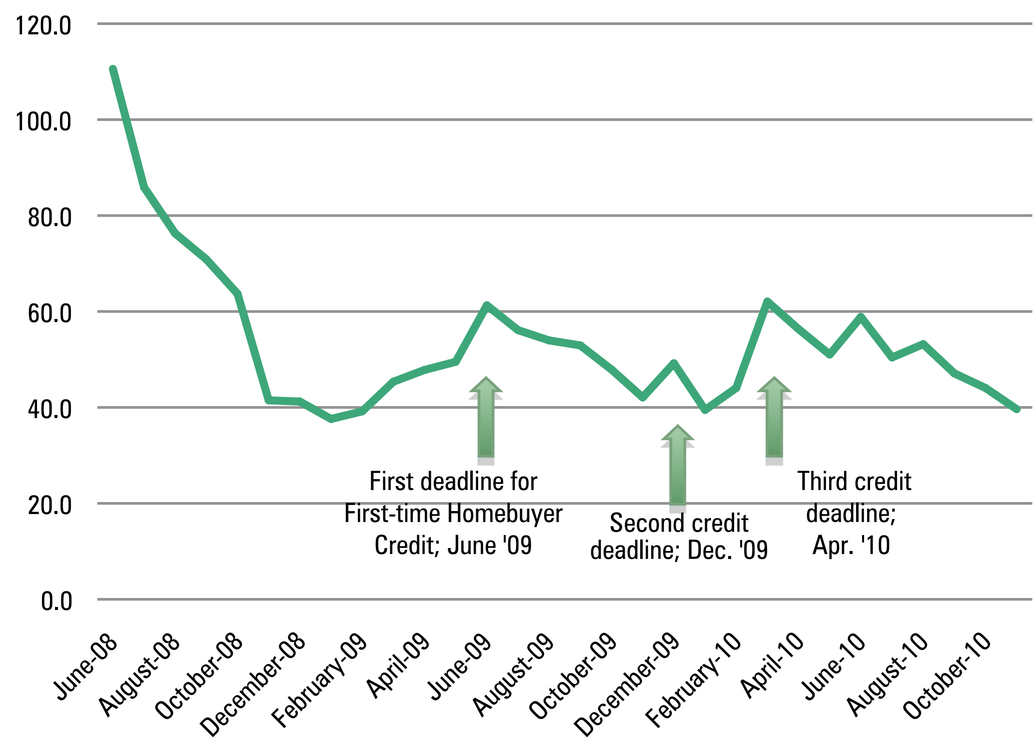
The Bush administration began a series of programs, continued and expanded by the Obama administration, aimed at pushing down mortgage rates and incentivizing homeownership. The government believes that by making home purchases more affordable, homebuyers will push the housing market out of its slump. As Secretary Paulson said: "The sooner we work through the housing correction, the sooner home prices will stabilize, and uncertainty about the values of mortgage-related assets will be more easily determined. So now, more than ever, we need Fannie and Freddie out there, financing mortgages."

The results of the government's efforts have been mixed, depending on the measure of success. The Treasury Department and Federal Housing Finance Administration (FHFA) have been aggressively using Fannie Mae and Freddie Mac to fund the market. This financing has helped push mortgage rates to record lows, which has in turn provided a strong incentive to buy a home or refinance. The government has sought to incentivize homeownership in other ways as well, including the First-Time Homebuyer Credit and the Federal Reserve's program to buy toxic debt from the GSEs in order to help keep mortgage rates even lower. For those looking to refinance, government has offered a series of programs under its Making Home Affordable banner. These programs have included modification and refinancing options subsidized by the government.

C. New Programs Fail to Generate Sustainable Growth

None of these programs has done much to promote sustainable housing growth, however. The First-Time Homebuyers tax credit caused a jump in home purchases each time it was set to expire, but it appears that the demand created was simply stolen from the future. Figure 5 shows the rate of applications for residential building permits declining in 2008 until the tax credit for buying a new home was established by the Housing and Economic Recovery Act of 2008 began to take effect. Building permits began to pick up in earnest in 2009 with the deadline for the credit set to expire. Those applying to build a new home dropped off after each deadline to qualify for the credit, but picked up with each deadline extension. The declines demonstrate that demand was artificially created and unsustainable. At the end of 2010, building permit requests were near historic lows.

Figure 5: Number of Building Permits Requested (in thousands)



Source: U.S. Census Bureau

The Federal Reserve and Treasury purchased $1.5 trillion in debt from Fannie Mae and Freddie Mac with the intention of helping the GSEs provide liquidity to the mortgage markets and to decrease the rate of interest on mortgages to unfreeze these markets. As the Federal Reserve Bank of New York says, “The goal of these purchases… is to reduce the cost and increase the availability of credit for the purchase of houses.” In one sense, this program has been a success. The GSEs have continued funding mortgages and rates have stayed at historical lows. However, these artificial lows have prevented housing prices from reaching their true bottom to restart stable growth. Furthermore, while trying to help homebuyers with low mortgage rates, the Fed program has hurt them by encouraging higher home prices.

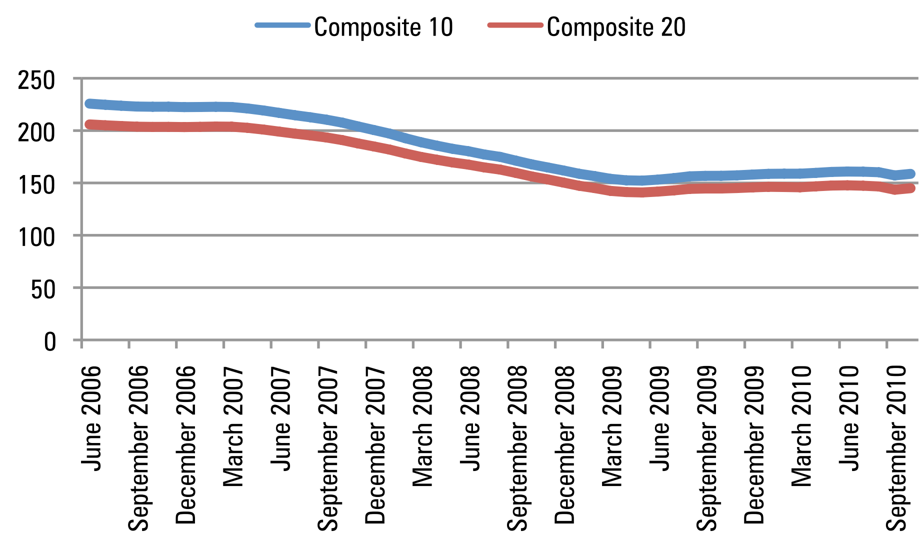
The government has also attempted to support the housing market by providing programs to prevent foreclosure and help homeowners afford their mortgage payments. The Home Affordable Refinancing Plan (HARP) aimed to give up to four to five million homeowners with loans owned or guaranteed by Fannie Mae or Freddie Mac an opportunity to refinance into more affordable monthly payments. However, this program has largely failed because those who took on unaffordable housing payments are unlikely to have the cash on hand necessary for refinancing, which generally requires putting equity into a home in order to push down its loan-to-value ratio. And only roughly 1% of mortgages refinanced through the program went to homes with LTV ratios over 105%, the real target of the program’s attempt to fight off negative equity and prevent payment problems.

The Home Affordable Modification Program (HAMP) committed $75 billion to keep up to four million Americans in their homes by modifying delinquent mortgages and preventing “avoidable foreclosures.” Several thousand mortgages were modified through the program in its first year, but nowhere near a significant enough number to impact the negative equity problem in the housing market. Furthermore, between 70% and 80% of those modified mortgages slipped back into delinquency within six months.

D. The Results of Failed Federal Housing Programs

The unfortunate result of the various government programs aimed at stabilizing the housing market and boosting homeownership has been nearly the opposite of intended. At the beginning of 2011, the American housing market remains very weak. Even with the programs incentivizing homebuyers to purchase now, housing price gains have been minimal. According to the Case-Shiller price index, housing values hit bottom in the first quarter of 2009, but they only bounced up 4% by the end of the year. And prices already began to slump again in 2010 in the wake of the tax credit expiration (see Figure 6). The rest of the gains will likely disappear over the next six to twelve months unless another program is instituted to prop up prices, perpetuating the artificial market that stands in the way of recovery.

Figure 6: S&P/Case-Shiller Housing Index June 2006 to October 010 (Seasonally Adjusted)



Source: Standard &Poor's/Case-Shiller

The most significant problem with the government's programs is the way they have slowed the realignment of the housing market. One of the reasons the housing bubble popped was that the supply of homes being built began to outpace demand. With more homes on the market, prices began to fall, exposing subprime mortgages and homes with little equity built in to severe delinquency problems. According to data from the Mortgage Bankers Association, delinquencies have been climbing at a steady rate since 2007, only beginning a sustained pattern of decline in the third quarter of 2010. And while the rate of foreclosures slowed down for the first time since 2007 in the third quarter of 2010, it was largely due to the robo-signing scandal forcing banks to reassess their foreclosure processing procedures. In fact, RealtyTrac.com reports that November 2010 marked the 21st straight month of more than 300,000 foreclosure filings.

Meanwhile, the government-subsidized low mortgage rates available have encouraged many to refinance, but the additional subsidy provided by HAMP and HARP has only delayed the inevitable need to foreclose. And that means that even with the foreclosure rate as bad as it is, the number should be higher. Combined with occasional foreclosure moratoriums by institutions or in certain areas and the high volume of defaults overwhelming delinquency processing units, there is a growing "shadow inventory" of homes. This inventory consists of homes that should be in foreclosure and available for a bank-owned sale. In November, CoreLogic reported that the shadow inventory had jumped 10% in 2010 to 2.1 million homes.

Keeping these homes off the market does two things. First, it distorts the supply and demand influence on prices. With more homes available, prices would be pushed lower. This would make negative equity problems worse, but it would also properly align the actual supply and demand for homes in America, allowing for a housing recovery to be built on a more stable foundation. Second, it drags out the pace that foreclosed homes hit the market, making the recovery process longer and more lethargic. It would be preferable to work out problems in the housing market sooner than later so that the economy can recover more quickly and thoroughly.

E. Building a Stable and Sustainable Housing Market

In order to build a sustainable housing market with stable growth, the housing finance system will need to be reformed. This overhaul process will have three components. The first is Fannie Mae and Freddie Mac reform. The second is fiscal policy reform on housing matters. And the third is developing a new regulatory framework to replace the outgoing system, including FHA reform. This process will be picked up and debated by the new 112th Congress.

GSE Reform: There is overwhelming support for a massive overhaul of Fannie Mae and Freddie Mac in all political camps. Their role at the heart of the housing bubble and subsequent crisis make the necessity of reform unmistakable. The question is how and when to move forward.

Dissolving Fannie Mae and Freddie Mac will be a complicated, but manageable process. Treasury Secretary Timothy Geithner testified in April 2010 that because Fannie and Freddie were so critical for the housing market today they should be left alone until the housing market recovers. The problem is that this means a “recovery” will be built on the same artificial and unstable foundation as the pre-crisis housing market. The second price bubble in housing is only creating more problems down the road.

Rather than wait and build an unstable housing recovery, GSE reform should begin now. One way to start the dissolution of Fannie Mae and Freddie Mac would be to reduce the conforming loan limits—currently $417,000 for standard conventional loans and $729,750 for so-called high cost living areas. This could be done over a three- to five-year window, phased down a certain amount each year until the GSEs no longer are able to finance mortgages. With the role of the GSEs in financing the market progressively wound down, the process of divesting GSE assets would begin.

All assets and obligations of the GSE would be sold by a specific set date. The size of the mortgage portfolio could be reduced by a certain percentage, such as 10% from the original amount each year (regardless of runoff) for four years and then 15% a year after that for a maximum of an 8-year wind down. Another idea would be to have Treasury buy the GSE’s existing mortgage portfolio of about $1.6 trillion (all in the form of MBS “guaranteed” by the GSEs) and also assume the GSE debt funding this portfolio (purchased at par and placed into a separate liquidating pool). This could help achieve substantial savings for the taxpayers since future GSE financing needs—while they are wound down—would be provided by U.S. Treasury debt, which is roughly 25 basis points cheaper than borrowing rates currently available to Fannie and Freddie.

There are other components of GSE reform that could be considered by policymakers in the coming years as well, both as accompanying policy changes to a wind down of Fannie and Freddie or as alternative ideas if substantive reform is political untenable. First, abolishing affordable housing goals for the GSEs while they stay in business, as well as for all other housing agencies, is a must. Second, putting the employees of Fannie and Freddie on federal payrolls would acknowledge their real function as an arm of the government, and the reduced compensation would encourage the staff of the GSEs to promote privatization efforts to be out from under the government's thumb. Third, Congress could increase the capital requirements of the GSEs so that their capital ratios treated debt and MBS more like private sector companies. Fourth, all remaining stock in Fannie and Freddie could be wiped out and the GSEs put on the federal budget. This would put an end to the government-sponsored enterprise model and harden the Treasury guarantee of GSE losses. Fifth, begin increasing the underwriting standards of loans purchased by the GSEs so that downpayments get to 20% (or 10% with private mortgage insurance). Finally, at the very least, Congress should require that Treasury exercise its authority to approve or disapprove all debt issuance from the GSEs so that there is additional transparency in the actions of Fannie Mae and Freddie Mac.

[For more detailed ideas on GSE reform, see Reason Foundation's "Rethinking Homeownership: A Framework for 21st Century Housing Finance Reform" at http://reason.org/news/show/rethinking-homeownership-a-framewor]

Fiscal Policy Reform: The government artificially distorts mortgage prices by a range of fiscal policies from tax law to Federal Housing Administration loans. First, the tax code incentivizes owning a home by making mortgage interest payments deductable. Interest on loans backed by up to $100,000 of home equity, no matter what the loan is used for, is also deductable from income tax returns. This creates an incentive to invest in homes in order to get the tax break, as opposed to potentially investing elsewhere.

Second, home sellers have been able to largely avoid paying capital gains taxes since 1997. Regulations restrict this capital gain exemption to once every three years, but there are exceptions even for this rule. In theory, reduced capital gains taxes would be positive for economic growth. However, this is problematic because it creates an exemption that unnaturally incentivizes investments in housing and distorts the natural flow of resources.

In order for the housing market to grow without artificial support from the government, these tax advantages for homeownership will have to be repealed. These combined distortions put upward pressure on the price of housing, increasing the value of homeowner investments in housing. However, the unnatural price support attracts resources away from other possible investments, creating bubbles and slowing the growth of other industries, while also pricing lower-income buyers out of the market.

A New Framework: With Fannie Mae and Freddie Mac dissolved, and federal subsidies and tax favoritism repealed, a large hole will open in the housing market and most federal subsidies for housing will be shifted to the Federal Housing Administration. As such, it is critical to note that Congress cannot dissolve the GSEs without at the same time addressing changes for FHA. Without proper reform affordable housing lending will shift over to this agency within HUD and begin repeating the mistakes of the past.

It has now become universally accepted that it is not a good idea to push people into homes they cannot afford. FHA (and others) should only encourage homeownership that is sustainable for the homebuyer. But assuming Congress will continue to support subsidizing at least very low-income housing as a social policy choice through FHA, any subsidies should be direct to the borrower, on-budget and subject to appropriations, narrowly targeted so as not to compete with the private sector, governed by accurate accounting methods, and built on sustainable underwriting standards.

Congress could pursue a number of possible policy changes. One suggestion would be to develop underwriting standards so that the probability of loss for FHA on a mortgage default is no greater than five times that of a loan to a highly-qualified borrower on a single-family purchase mortgage making a 20% down payment. Another, congruent idea is to have FHA mirror the standards in place for rural housing programs by limiting mortgage sizes to 100% of median housings values as measured on the local level and cap the income of a FHA loan recipient at 80% of local median income. FHA could also require lenders to repurchase any loan in which the borrower misses three consecutive payments within the first 24 months of the loan. It might also encourage more skin in the game for lenders by moving away from the 100% guarantees as currently offered, even if the move is small.

For the rest of the market, mortgage lending may shift significantly. For decades, the market has been dependent on the GSEs for liquidity, and without this support, the private sector will have to gradually move into the secondary mortgage market.

The government can have a role to play, in both ensuring fair competition in the mortgage market and using legislation to make mortgage-financing innovation easier and more lucrative. Specific innovations cannot be decided on ahead of time by policymakers; they must be organic and develop where there is a market for them. But policymakers can design rules and regulations to encourage private capital as the sole source of mortgage financing when the ideas surface.

One example is covered bonds, an alternative to mortgage-backed securities, which packages mortgages into bonds (instead of securities), with cash flows from mortgage payments going to the bondholder. What makes a covered bond unique is that the originator holds the originated mortgages on its books and guarantees them with other assets on its books. The model requires originators to have a vested interest in the health and stability of the loan, instead of the originate-to-distribute model that plagued the industry during the house boom.

The government can also have a role in promoting transparency and prosecuting fraud. The more consumers know about the firms they are borrowing from, the better consumers will be at selecting quality products and the more businesses will seek to provide quality service. Furthermore, claims of fraud or dishonesty should be pursued with greater vigilance to create an expectation of enforcement. Regulators should leverage the importance of business reputation. If a particular firm were constantly under investigation for fraudulent businesses practices, that would certainly hurt its profit margin and thus create incentives to be more honest with high service quality.

Incentivizing consumers to educate themselves would go a long way to avoid a host of problems in the future. Buying a house is a big deal, and consumers should take the time to understand what they are buying. It is not unreasonable to believe that if a consumer does not want to take the time to understand his mortgage, he may not be ready for homeownership. Firms cannot deceive or abuse prepared consumers. Perhaps the best way to do this would be to remove safety nets for consumers by reducing their recourse to prosecute lenders. If consumers knew their options would be limited if their investments went bad, they would have more incentive to learn about the mortgages they are taking out.

F. Conclusion

Building a sustainable housing market means pure private sector financing, and no federal subsidies skewing the supply and demand incentives of lenders or buyers. Such a market, coupled with a regulatory framework that removes barriers to mortgage lending and financial innovation, would help the housing market grow with stability. It would also, however, look very different than the market today.

In order for a privatized housing finance market to work, the government and the American people will need to change the way homeownership is perceived. For decades homeownership has been held up as a universally wise investment strategy, synonymous with the American Dream. Yet, the 21st Century is changing this reality for the United States. As American society has become more mobile, investment in fixed assets has become less attractive. The returns on the investment are in decline, and the ways homeownership can stagnate a society are surfacing in new and more convincing ways.

This is not to say that homeownership is a bad thing. Rather, homeownership is no longer assumed to be inherently a good thing for all people. As such, the main goal of reform should be to shift the mindset of policymakers from promoting affordable housing to promoting real wealth-building. Building wealth is not an easy thing to do. It requires hard work, discipline, thrift and personal responsibility. Homeownership may or may not be a good tool for building wealth, depending on the individuals involved, the geographical location of the home, employment status and available cash for a down payment. Ultimately, with an economy and population as diverse and dynamic as the United States, the government should realize it should not try to use policy as a means of promoting any societal aim—even homeownership.

The role of government should be to support a sustainable regulatory structure for the private sector financing of mortgages. Federal involvement in housing finance ultimately distorts the market by placing unnatural upward pressure on home prices and downward pressure on mortgage yields. This isn't a stable system that benefits taxpayers in the long run. A reformed housing finance regulatory structure should be used to align business and consumer interests more acutely, prevent fraud and ensure the market is a just field for competition.

A key step in the process of reform will be dissolving Fannie Mae and Freddie Mac without replacing them with another market-distorting housing agency or similar explicit guarantee for mortgage financing. The resulting change will require a significant shift in the way of thinking about housing finance. The new market will be different than yesterday or today's housing market. Mortgages may not be as readily available as before, and prices will likely be different. But the goal shouldn't be to return to the market conditions of the bubble. That is unsustainable. Instead, the focus should be on building stable wealth over a long period of time while avoiding policies that distort the market and lead to calamitous results.

Part 5

Military Housing Privatization Update

The U.S. military continued its successful Military Housing Privatization Initiative (MHPI) in 2010. Since the MHPI was enacted as part of the National Defense Authorization Act in 1996, various branches of the military have undertaken about 100 projects covering a total of 186,870 housing units (see Table 3). Cost savings from the program are estimated at 10%. In addition, privatization has allowed the government to leverage private sector capital for the housing projects, averaging a 10:1 leverage ratio ($10 of housing development for every $1 appropriated by Congress).

In August 2010 Fort Polk in Louisiana became the first U.S. Army base to open a Holiday Inn Express. An August 4th ceremony marked the completion of phase one of the three-phase project, undertaken under the Army's Privatization of Army Lodging (PAL) program. Under the deal, Actus Lend Lease is providing the capital for the project and will own the new hotels, which will be operated by InterContinental Hotel Group. The Fort Polk project is part of a larger initiative, PAL Group A, which includes private renovation and construction of housing facilities at 10 Army installations nationwide. In addition to Fort Polk, the other installations include Fort Rucker, AL; Yuma Proving Ground, AZ; Fort Shafter/Tripler Army Medical Center, HI; Fort Leavenworth, KS; Fort Riley, KS; Fort Sill, OK; Fort Hood, TX; Fort Sam Houston, TX; and Fort Myer, VA.

Phase one included the renovation of the former Magnolia Guest House and an upgrading of the facility's amenities. The newly renovated facility offers complimentary hot breakfasts served daily, a television lounge, business center, guest laundry services and a courtesy shuttle. Renovations include an upgraded lobby and front desk, new carpeting and window treatments, new laundry equipment, new paint, repairs to railings, fire alarm system replacements and improved air conditioning in guest rooms. Each room contains new furnishings, new bedding and linens, granite vanities in the bathrooms and flat screen televisions.

Phase two includes the renovation of 70 rooms at Cypress Inn, expected to be completed by November or December. Phase three will consist of the construction of a 200-room Staybridge Inn Suites, designed for recreation, vacation and extended-stay business. Groundbreaking is scheduled for 2012 or 2013.

"Fort Polk was selected to be part of a pilot program for the privatization of lodging in the Army," Fort Polk garrison commissioner Col. Francis Burns told the *Fort Polk Guardian* in August 2010.

"Of the almost 17,000 rooms in the Army inventory, more than 80% needed to be replaced or renovated. The cost was expected to be more than $1 billion to the Army and would take about 20 years to complete."

Table 2: Benefits of Living in Privatized Housing		
Development Benefits	Community Benefits	Cost Benefits
▪ More square footage than traditional military construction ▪ Quality construction ▪ Modern appliances, cabinetry, and fixtures ▪ Lawn maintenance at some communities ▪ Garages versus carports in most homes	▪ Playgrounds ▪ Community centers ▪ Swimming pools ▪ Basketball/volleyball/ tennis courts ▪ Community activities such as: ▪ Educational/safety events ▪ Holiday celebrations ▪ Family and community bonding activities	▪ Basic Allowance for Housing (BAH) covers all rent ▪ Utility allowance provided – efficient energy use means no out-of-pocket expenses ▪ Renter's insurance provided at most communities ▪ Convenient access to work and base services

Source: U.S. Air Force Center for Engineering and the Environment

In October 2010, Actus and the Army announced the financial closing of a $377 million, seven-year project to construct 414 new homes and renovate 169 existing homes at Fort Wainwright and Fort Greely in Alaska. In all, the North Haven Communities project will consist of the development, construction, renovation and management of 1,815 homes, as well as community centers, playgrounds and other amenities, over a 50-year period. In consideration of the few hours of daylight the area receives during the winter months, special attention will be given to homes designs, including bright colors, natural lighting, full-spectrum lighting in bathrooms and kitchens, and spacious living areas.

Under the MHPI, each military service has its own privatization program. The Army's program is the Residential Community Initiative, the Navy's program is called Public Private Ventures, and the Air Force's program is referred to as simply Housing Privatization. At the beginning of the program in 1996, the Department of Defense (DoD) had an inventory of approximately 257,000 family housing units. Current plans are to privatize roughly 190,000 to 195,000 units, or about 75% of existing family housing units worldwide.

The military considers the program a tremendous success, allowing it to leverage private capital to more quickly and cheaply maintain and improve high-quality housing for servicemembers and their families, thus saving the government money while improving the morale of servicemembers. Moreover, since housing is not a core function or area of expertise for the military, privatization has freed up time and resources for the military to redirect to more core competencies. According to the U.S. Office of the Under Secretary of Defense for Acquisition, Technology and Logistics:

> *The MHPI program was created to address two significant problems concerning housing for military service members and their families. The first problem was the poor condition of DoD-owned housing. At the beginning of the program, DoD owned worldwide*

approximately 257,000 family housing units both on and off-base. Over 50% of the units needed to be renovated or replaced because over the past 30 years they have not been sufficiently maintained or modernized. The second problem was a shortage of affordable private sector housing of adequate quality.

The situation led to a decline in readiness and morale among Service members. DoD was unable to address the critical housing needs because of existing budgetary constraints. Using the traditional approach to military construction, it would cost taxpayers nearly $25 billion and it would take 20 years to solve this housing problem. MHPI provides a creative and effective solution to addressing the quality housing shortage. For DoD, MHPI results in the construction of more housing built to market standards, for less money than through the military construction process. Commercial construction is not only faster and less costly than military construction, but private sector funds significantly stretch and leverage DoD's limited housing funds.

In addition to the approximately 100 projects awarded over the past 14 years covering over 186,000 units (see Table 3), as of January 2010 an additional 37 projects were pending, with estimated award dates between fiscal years 2010 and 2013. These military housing privatization projects would include over 28,500 housing units (see Table 4).

Table 3: Military Housing Privatization Projects Awarded (as of January 2010)

Project	# of Units	Award Date	Developer
Mid-Atlantic 3 (Camp Lejeune)	451	Dec 2009	Lincoln
Fort Huachuca & Yuma Proving Ground, AZ	1,169	Apr 2009	Michaels Military Housing
Fort Wainwright & Fort Greely, AK (Phase 1 & 2)	1,815	Apr 2009	Actus Lend Lease
Falcon Group (Moody, Little Rock, Patrick, Hanscom AFBs)	2,621	FY 2008	Pinnacle / Hunt
Lackland AFB, TX (Phase 2)	465	Nov 2008	Balfour Beatty Communities
Fort Lewis / McChord AFB, WA (Joint Base)	4,631	Nov 2008	Equity Residential
Fort Sill, OK	1,650	Nov 2008	Picerne
Fort Drum, NY (Phase 2)	554	Sep 2008	Actus Lend Lease
Fort Jackson, SC	850	Aug 2008	Balfour Beatty Communities
West Point, NY	824	Aug 2008	Balfour Beatty Communities
Fairchild AFB, WA; Tinker AFB, OK; Travis AFB, CA (AMC West)	2,435	Jul 2008	Balfour Beatty Communities
Fort Jackson, SC	850	Jul 2008	Balfour Beatty Communities
Andrews AFB, MD; MacDill AFB, FL (AMC East)	1,458	Nov 2007	Clark Realty Capital
Vandenberg AFB, CA	867	Nov 2007	Balfour Beatty Communities
Peterson AFB, CO; Schriever AFB, CO; Los Angeles AFB, CA (Tri-Group)	1,564	Sep 2007	Actus Lend Lease
Barksdale AFB, LA; Langley AFB, VA; Bolling AFB, DC	3,189	Sep 2007	Pinnacle / Hunt
Navy-Southeast Regional (includes sites in SC, MS, GA, and TX)	5,269	Sep 2007	Balfour Beatty Communities

Table 3: Military Housing Privatization Projects Awarded (as of January 2010)			
Project	# of Units	Award Date	Developer
Navy-Midwest, South Millington, TN (Phase 2)	N/A	Sep 2007	Forest City
Navy-San Diego, CA – Phase 4 (includes Navy sites in CA and NV)	N/A	Sep 2007	Lincoln / Clark
MCB Hawaii, HI (Phase 4)	N/A	Sep 2007	Forest City
MCB Camp Lejeune/Cherry Pt., NC; Westover, MA	N/A	Sep 2007	Actus Lend Lease
MCB Camp Pendleton, CA; Albany, GA (Phase 5)	N/A	Sep 2007	Hunt / Linclon / Clark
Robins AFB, GA (Phase 2)	207	Sep 2007	Hunt
Columbus AFB, MS; Goodfellow AFB, TX; Laughlin AFB, TX; Maxwell AFB, AL; Randolph AFB, TX; Vance AFB, OK (AETC 2)	2,257	Sep 2007	Pinnacle / Hunt
Fort Lee, VA	1,590	Sep 2007	Hunt / Pinnacle / Falcon
Hickam AFB, HI (Phase 2)	1,118	Aug 2007	Actus Lend Lease
Davis-Montham AFB, AZ; Holloman AFB, NM	1,838	Jul 2007	Actus Lend Lease
USAF Academy, CO	427	May 2007	Forest City / Hunt
Altus AFB, OK; Luke AFB, AZ; Sheppard AFB, TX; Tyndell AFB, FL (AETC 1 group)	2,875	Feb 2007	Balfour Beatty Communities
Fort Knox, KY	2,527	Dec 2006	Actus Lend Lease
Redstone Arsenal, AL	230	Oct 2006	Hunt
McGuire AFB / Fort Dix, NJ (Joint Base)	2,084	Sep 2006	United Communities Development
Navy-Hawaii, HI (Phase 3)	N/A	Sep 2006	Forest City
MCB Hawaii, HI (Phase 2)	N/A	Sep 2006	Forest City
MCB Camp Pendleton, CA (Phase 4)	N/A	Sep 2006	Hunt / Lincoln / Clark
MCB Camp Lejeune / MCAS Cherry Point, NC (Phase 2)	N/A	Sep 2006	Actus Lend Lease
Fort Riley, KS	3,514	Jul 2006	Picerne
Northeast Integrated Phase 2—Carlisle Barracks, PA / Picatinny Arsenal, NJ	348	May 2006	Balfour Beatty Communities
Naval Complex San Diego, CA (Phase 3)	N/A	May 2006	Lincoln / Clark
Nellis AFB, NV	1,178	May 2006	Hunt
Fort Gordon, GA	887	May 2006	Balfour Beatty Communities
Fort Rucker, AL	1,476	Apr 2006	Picerne
Fort Leavenworth, KS	1,583	Mar 2006	Michaels Military Housing
Fort Benning, GA	4,200	Jan 2006	Clark / Pinnacle
Scott AFB, IL	1,593	Jan 2006	Hunt
Midwest Regional (Naval Station Great Lakes, IL; Naval Support Activity Center Crane, IN)	1,976	Dec 2005	Forest City
MCB Camp Lejeune / MCAS Cherry Point, NC (Stewart Terrace Housing, NY)	N/A	Sep 2005	Actus Lend Lease
MCAGCC Twentynine Palms, CA; MCAS Kansas City, MO	N/A	Sep 2005	Hunt / Lincoln / Clark
Dover AFB, DE	980	Sep 2005	Hunt

Table 3: Military Housing Privatization Projects Awarded (as of January 2010)			
Project	# of Units	Award Date	Developer
Hill AFB, UT	1,018	Sep 2005	The Boyer Company
Offutt AFB, NE	1,640	Sep 2005	America First
Navy – Mid-Atlantic Region (VA, WV, MD)	5,839	Aug 2005	Lincoln
Fort Bliss, TX; White Sands Missile Range, NM	3,277	Jul 2005	Balfour Beatty Communities
Fort Drum, NY (Phase 1)	3,307	May 2005	Actus Lend Lease
Fort Leonard Wood, MO	2,242	Mar 2005	Balfour Beatty Communities
Fort Sam Houston, TX	925	Mar 2005	Lincoln
Navy – Northwest Region, WA (Phase 1)	2,985	Feb 2005	Forest City
Hickam AFB, HI (Phase 1)	1,356	Feb 2005	Actus Lend Lease
Fort Eustis / Fort Story, VA	1,124	Dec 2004	Balfour Beatty Communities
Navy – Northeast Region (sites in NY, NJ, CT, RI, ME)	4,264	Nov 2004	Balfour Beatty Communities
Fort Shafter / Schofield Barracks and other HI Army locations	7,984	Oct 2004	Actus Lend Lease
Hanscom AFB, MA (Falcon Group)	N/A	Oct 2004	Pinnacle / Hunt
MCAS Yuma, AZ; MCB Camp Pendleton, CA (Phase 3)	N/A	Oct 2004	Hunt / Lincoln / Clark
Fort Polk, LA	3,821	Sep 2004	Picerne
Elmendorf AFB, AK (Phase 2)	1,194	Sep 2004	Aurora
Buckley AFB, CO	351	Aug 2004	Investment Builders Corp.
Northeast Integrated -- Walter Reed Army Medical Center, DC; Fort Detrick, MD (Phase 1)	590	Jul 2004	Balfour Beatty Communities
Little Rock AFB, AR (Falcon Group)	N/A	Jul 2004	Pinnacle / Hunt
Fort Hamilton, NY	228	Jun 2004	Balfour Beatty Communities
Navy Regional, HI (Phases 1 through 4)	6,557	May 2004 to Sep 2007	Forest City
Fort Irwin / Moffett Field / Parks Training Area, CA	3,126	Mar 2004	Clark / Pinnacle
Moody AFB, GA (Falcon Group)	N/A	Feb 2004	Pinnacle / Hunt
Fort Campbell, KY	4,455	Dec 2003	Actus Lend Lease
Fort Belvoir, VA	2,070	Dec 2003	Clark / Pinnacle
Fort Stewart / Hunter Army Airfield, GA	4,036	Nov 2003	Balfour Beatty Communities
Fort Bragg, NC	6,517	Nov 2003	Picerne
Presidio of Monterey / NPS Monterey, CA	2,209	Oct 2003	Clark / Pinnacle
Patrick AFB, FL (Falcon Group)	N/A	Oct 2003	Pinnacle / Hunt
MCB Camp Pendleton, CA – Phases 2 through 5 (includes Navy sites at MCB Quantico, VA; Yuma, AZ; Albany, GA; Kansas City, MO; and Twentynine Palms, CA)	10,375	Sep 2003 to Sep 2007	Hunt / Lincoln / Clark
Naval Complex San Diego, CA (Phase 2)	N/A	May 2003	Lincoln / Clark
Kirtland AFB, NM	1,078	Apr 2003	Hunt
MCB Camp Lejeune / Cherry Point, NC – Phases 1 through 3 (includes Navy sites in Westover, MA;	8,059	Mar 2003 to Sep	Actus Lend Lease

Table 3: Military Housing Privatization Projects Awarded (as of January 2010)			
Project	# of Units	Award Date	Developer
Stewart, NY; MCAS Beaufort, SC; and MCRD Parris Island, SC)		2007	
Wright-Patterson AFB, OH	1,536	Aug 2002	Miller-Valentine / Woolpert / Hunt
Fort Meade, MD	3,170	May 2002	Picerne
Fort Lewis, WA (Joint Base Lewis/McChord)	N/A	Apr 2002	EQR Lincoln Properties
Naval Complex South Texas	665	Feb 2002	Landmark Organization
Fort Hood, TX	5,912	Oct 2001	Lend Lease Actus
Naval Complex New Orleans, LA	941	Oct 2001	Patrician Management
Naval Complex San Diego, CA – Phases 1 through 4 (includes Navy sites in NV)	14,265	Aug 2001 to May 2006	Lincoln / Clark
Elmendorf AFB, AK	828	Mar 2001	Aurora Military Housing LLC / Hunt
Naval Station Everett II, WA	288	Dec 2000	Gateway
MCB Camp Pendleton, CA (Phase 1)	712	Nov 2000	Hunt
Naval Air Station Kingsville, TX (Phase 2)	150	Nov 2000	Hunt
Robins AFB, GA (Phase 1)	670	Sep 2000	Hunt
Dyess AFB, TX	402	Sep 2000	Hunt
Fort Carson, CO (Phases 1 and 2)	3,087	Sep 1999	Balfour Beatty Communities
Lackland AFB, TX	420	Aug 1998	Balfour Beatty Communities
Naval Station Everett, WA (Phase 1)	185	Mar 1997	Dujardin
Naval Air Station Corpus Christi / NAS Kingsville, TX	404	Jul 1996	Landmark Organization
Total	186,870		

Source: Office of the Under Secretary of Defense for Acquisition, Technology and Logistics

Table 4: Military Housing Privatization Projects Pending (as of January 2010)		
Installation	# of Units	Estimated Award Date
MCB Camp Pendleton and MCAGCC Twentynine Palms, CA (Phase 6)	285	FY 2010
MCB Camp Lejeune, NC (Phase 3)	2,477	FY 2010
Aberdeen Proving Ground, MD	372	FY 2010
Fort Bliss, TX / White Sands Missile Range, NM (Phase 2)	202	FY 2010
Mid-Atlantic – NSA Washington, Annapolis, McChanicsburg (Phase 2)	378	FY 2010
Fort Bragg, NC (Phase 2)	267	FY 2010
Fort Irwin / Moffett Field / Parks Training Area, CA (Phase 3)	184	FY 2010
Wright-Patterson AFB, OH (Phase 2)	101	FY 2010
MCB Camp Pendleton, CA (Phase 7)	367	FY 2010
Fort Lewis, WA (Joint Base Lewis/McChord)	378	FY 2010

Table 4: Military Housing Privatization Projects Pending (as of January 2010)		
Installation	# of Units	Estimated Award Date
Fort Polk, LA	144	FY 2010
Fort Knox, KY (Phase 2)	129	FY 2010
Fort Sill, OK	78	FY 2010
Southern Group (Charleston AFB, SC; Shaw AFB, SC; Arnold AFB, TN; and Keesler AFB, MS)	2,185	FY 2010
Continental Group (Eglin AFB, FL; Hurlburt Field, FL; Edwards AFB, CA; McConnell AFB, KS; and Seymour Johnson AFB, NC)	3,636	FY 2010
Northern Group (Mountain Home AFB, ID; Minot AFB, ND; Cavalier AFS, ND; Grand Forks AFB, ND; Ellsworth AFB, SD; and Cannon AFB, NM)	4,549	FY 2010
Elmendorf/Fort Richardson, AK Joint Base	2,610	FY 2010
Fort Wainwright, AK (Phase 3)	176	FY 2010
Fort Carson, CO (Phase 3)	753	FY 2010
Western Group (F.E. Warren AFB, WY; Malmstron AFB, MT; Whiteman AFB, MO; and Beale AFB, CA)	3,265	FY 2010
Mid-Atlantic – MCB Camp Lejeune, NC (Phase 4)	394	FY 2010
Elison AFB, AK	780	FY 2010
Dyess AFB, TX (Phase 2)	674	FY 2010
MCB Camp Pendleton, CA (Phase 8)	600	FY 2010
MCB Camp Lejeune, NC (Phase 6)	231	FY 2010
Fort Stewart, GA	523	FY 2010
San Diego, CA (Phase 5)	259	FY 2010
Fort Eustis / Fort Story, VA (Phase 2)	8	FY 2011
MCB Camp Pendleton, CA (Phase 9)	351	FY 2011
Fort Bliss, TX (Phase 3)	657	FY 2011
MCB Camp Pendleton, CA (Phase 10)	104	FY 2011
MCB Camp Lejeune, NC (Phase 7)	220	FY 2011
MCB Hawaii (Phase 5)	520	FY 2011
Fort Bragg / Pope AFB, NC	206	FY 2011
MCB Camp Pendleton, CA (Phase 11)	107	FY 2012
MCB Camp Lejeune, NC (Phase 8)	181	FY 2012
MCB Camp Lejeune, NC (Phase 9)	158	FY 2013
Total	28,509	

Source: Office of the Under Secretary of Defense for Acquisition, Technology and Logistics

Part 6

Progress on Federal Real Property Management

The fiscal challenges facing Washington are driving members of both parties to seek out new efficiencies to get spending under control, including initiatives for more effective management of federal property. In June 2010, President Obama signed a memo directing agencies to accelerate their efforts to divest excess and surplus property in an effort to achieve upwards of $8 billion in savings by fiscal year 2012. This presidential order also asks agencies to find ways to consolidate office space, reduce operating costs, eliminate wasteful lease arrangements and use space management techniques more efficiently.

Four months later, in October 2010, the Republicans on the House Transportation and Infrastructure Committee released a report entitled "Sitting on Our Assets: The Federal Government's Misuse of Taxpayer-Owned Assets." This report echoed the sentiments of the White House statement and pointed out specific properties that should be divested, including the Old Post Office building in downtown Washington D.C. that is partially vacant and costs taxpayers $6.5 million a year.

In total, the Republican report estimates that the government could achieve savings of up to $270 billion over 10 years utilizing such strategies as selling unnecessary real estate assets, expanding the use of public-private partnerships for transportation infrastructure projects, streamlining the approval of transportation projects, renegotiating leases to take advantage of depressed market rates and reallocating and otherwise improving management of existing assets.

Former Office of Management and Budget director Peter R. Orszag said on his blog in June that the federal government owns "1.2 million buildings, structures, and land parcels" including "14,000 building[s] and structures currently designated as excess and 55,000 identified as under- and not-utilized." However, this assessment comes from an incomplete database built from inconsistent data managed mainly by the agencies themselves, with each using its own inventory method rather than an accurate, centralized inventory.

The GOP report notes that the General Services Administration's existing inventory of government-owned properties is "aging" and "draining resources" due to repairs and maintenance. Further, the report proposes GSA take "dramatic steps to right-size its real property inventory and to improve its asset management strategy," echoing previous calls for a more efficient federal real property management system.

In 2004, the Bush administration took a significant step toward efficient real property management with Executive Order 13327, which directed agencies to "identify and categorize all real property owned, leased, or otherwise managed by the agency." The order established the Federal Real Property Council (FRPC) to provide procedures and performance measures to identify and eliminate wasteful spending. The FRPC publishes an annual guide for inventory reporting and has created reporting standards.

However, over six years later, the federal government still lacks a comprehensive and robust real property inventory. The Federal Real Property Profile, created in accordance with the Bush administration order, estimates the government owns or leases a total of 3.87 billion square feet of property and 55.7 million acres of land. However, a July 2009 report from the GAO says the data are unreliable.

According to "Sitting on Our Assets," the government manages 896,000 buildings and structures with a total area of 3.29 billion square feet and more than 41 million acres of land. The GSA alone owns or leases 9,600 assets and maintains an inventory of more than 362 million square feet of space.

An administration spokesperson told *Government Executive* in November 2010 that the president is committed to "aggressive steps to save taxpayer dollars while making government work better, harder and more efficiently for the American people."

As a June 2010 Reason Foundation report notes, real property management is not a Democrat or Republican issue. It is not an issue of spending priorities. Rather, it is a good governance issue and a fiscal responsibility issue. And as President Obama reaffirmed in his 2012 budget proposal, better management of public property should remain on the national agenda.

The first crucial step towards saving taxpayer funds through wise management of federal assets is to fully inventory what the government owns and manages. This requires building a comprehensive inventory of properties to functions as a tool for prudent asset management during even the best of times. With budget reform pressures mounting on both parties due to the exploding deficit, creating real property inventories should be a priority for 2011.

For More Information

- House Transportation and Infrastructure Committee Republican Staff, "Sitting on Our Assets: The Federal Government's Misuse of Taxpayer-Owned Assets," at http://republicans.transportation.house.gov/singlepages.aspx/979

- Reason Foundation, "Knowing What You Own: An Efficient Government How-To Guide for Managing Federal Property Inventories" at http://reason.org/files/how_to_manage_or_sell_federal_property.pdf

- *Government Executive*, "Plan to sell federal real estate rises on GOP agenda." Available at http://www.govexec.com/dailyfed/1110/110310cc1.htm

[Note: This update replaces an earlier version of the article in the original report.]

Reason Foundation
3415 S. Sepulveda Blvd., Suite 400,
Los Angeles, CA 90034
310/391-2245
www.reason.org