

## PRIVATIZATION OF ARMY LODGING

BY

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USAWC STRATEGY RESEARCH PROJECT

**PRIVATIZATION OF ARMY LODGING**

by

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## **ABSTRACT**

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One of the key issues and platforms that President Bush utilized during first election campaign was that the United States Government needs to operate in a more business-like manner. Key to moving this campaign promise forward and implementing reforms to improve the performance of government he issued the President's Management Agenda (PMA). One of the key components of the PMA is competitive sourcing. This includes contracting out services and privatizing operations when the private sector can provide the services in an efficient and effective manner at a reduced cost to the tax payer. One of the most visible program initiatives in the PMA is the Privatization of Military Housing. The Department of Defense (DoD) has been at the forefront of contracting out various non-core competencies long before the PMA was published. The Privatization of Military Housing has been deemed a success and the Army is now in the process of Privatizing Army Lodging. This project will examine if privatizing Army Lodging fits the criteria of the PMA and is the most cost effective operating approach. It also will develop the key issues surrounding this initiative and explore other courses of action that may achieve greater efficiencies than privatization.



## PRIVATIZATION OF ARMY LODGING

Over the past decade the Army privatized over 99% of its housing units through the Residential Housing Initiative (RCI).<sup>1</sup> The Army is now in the process of using the RCI model that worked well for housing to privatized Army Lodging. This paper will analyze the history of outsourcing, present lessons learned from past initiatives, develop alternatives, and develop a recommendation for the US Army Lodging Program based on the directive of the President's Management Agenda (PMA).<sup>2</sup> The PMA is a set of initiatives designed to improve the management of federal agencies by adopting performance-based criteria for decision-making and action, and ultimately tying performance to budget appropriations. The five pillars of the PMA are:

- Strategic Management of Human Capital
- Competitive Sourcing
- Budget and Performance Integration
- Improved Financial Performance
- Expanded Electronic Government

In order to achieve the PMA, the federal government must change the fundamental ways it operates. It must move towards an operating environment that is based on competitive markets where the method for delivering a government product or service will be awarded to a private company or government entity that can accomplish it in the most efficient and effective manner. Competition is a major component of President Bush's Management Agenda. The concept is called "Competitive Sourcing," which simply means a systematic effort to have all commercial activities in the federal government periodically go through a process of competition. Commercial activities

have been identified for several years in the Federal Activities Inventory Reform (FAIR) Act inventories. President Bush and the Office of Management and Budget (OMB) issued requirements in 2003 that agencies conduct public-private competitions for at least 10 percent of the inventory. Under OMB Circular A-76,<sup>3</sup> competitive sourcing is a process of competition where the group providing the best value to the taxpayers earns the right to perform the function. Historically the in-house federal government team has won more than 51 percent of competitions against private companies.<sup>4</sup> The Department of Defense (DoD) has been at the forefront of competitive sourcing and has gained the greatest amount of experience over all other government agencies.

The objective of the PMA and A76 competitions is to ensure products and services are delivered in the most efficient and cost effective manner. These programs were never meant to contract out services just to move those services to the private sector. "To ensure DoD employees get to compete fairly, a provision was added to the 2004 defense appropriation bill that guarantees defense employees the right to restructure their work units as "most efficient organizations" (MEO). The MEO can be developed through restructuring human resources, processes, technology, and other efficiency producing strategies when competing against contractors over who can do the work best and at the lowest cost."<sup>5</sup> This provision is important because DoD and the US Army rely heavily on contracting out to commercial entities assuming they will always save money. This is not always the case, especially in the long run, and once you contract out a large operation it is extremely difficult to ever bring it back.<sup>6</sup> DoD is now forced to review both commercial entities and government in-house bids and award to the MEO. It is important to note that the government is a non-profit organization,

whereas, commercial entities require a profit, pay taxes, and in most cases pay dividends, service debt, etc., all expenses the federal organization does not have.

Over the past few years the US Army has conducted an extensive evaluation of its military housing. Military housing has three main components, Accompanied Permanent Party Housing (Family Housing), Un-accompanied Permanent Party Housing (Barracks), and Transient Housing (Lodging). Over the past 30 years the Army's infrastructure has been declining rapidly. The Army's Business Initiatives Council (BIC) developed the Residential Communities Initiative (RCI) to solve the Family Housing issue, and is now looking to the BIC process to resolve the Lodging infrastructure problem.

In August 2002, the Secretary of the Army approved eight new Army business initiatives as part of a formal DoD process designed to identify and implement business reform actions that create greater efficiencies and cost savings. The approved initiatives, which were worked through the BIC, included the Privatization of Army Lodging (PAL). Army Lodging is official government quarters for transient unaccompanied military personnel, Department of Defense employees, military retirees, and other eligible patrons either on temporary duty orders or for a permanent change of duty station.<sup>7</sup> The key question is how to provide lodging facilities and services in the most cost effective and efficient manner based on a standard level of service and quality. The PAL initiative covers 98 lodging operations consisting of 19,000 rooms in the continental United States, Alaska, and Hawaii. The estimated cost to revitalize operations is over \$1 billion the Army estimates. In September 2006, the Army entered into an agreement with Actus Lend Lease to prepare the Lodging Development and

Management Plan (LMDP) for 13 military installations. The LMDP must then be approved by HQDA, OSD, OMB, and then Congress must approve the transfer of assets to Actus. Actus will develop the properties and has selected InterContinental Group to manage the operations.<sup>8</sup>

## History

There are two key initiatives driving the PAL program. The first is President Bush's PMA that establishes his administration's commitment to expanding the use of competitive contracting in the federal government and opening more federal positions involving commercial activities to competition from the private sector. "At all levels of government throughout America, as well as in other countries, competitive contracting is maximizing market forces and allowing the public sector to lower taxpayer costs while improving services."<sup>9</sup> The second initiative is the Army's desire to focus on its core functions of training and equipping soldiers, growing leaders, conducting military operations to protect the country. To that end, DA is reviewing its activities and evaluating the contracting out all non-core functions.<sup>10</sup>

Secretary of Defense Donald Rumsfeld created the BIC process in June 2001. Both the Army and the DoD Business Initiatives Councils focus on finding ways to streamline stringent legislative requirements, cumbersome directives, and lengthy staffing processes. An important BIC philosophy is that savings will be retained by the organization that executes the initiative, thus encouraging organizations to be innovative in their proposals. "The anticipated results of Army BIC initiatives are efficiencies that will free manpower and funding resources to be reallocated to Army Transformation," said Dr. Craig College, the Deputy Assistant Secretary of the Army for Infrastructure

Analysis (US Army News Release, 2002). In the case of PAL, the BIC initiative focuses on competitive contracting. Competitive contracting is one of several techniques described as *privatization*--the process by which the fulfillment of certain public services and functions is transferred from the government to private sector providers. Privatization relies on the marketplace to achieve cost saving and improve service. Competitive contracting is based on the principle that what is most important is the cost, quality, and availability of the service, not who provides it.<sup>11</sup>

Past history of competitive contracting has shown favorable results. According to the Office for Management and Budget, from 2002 to 2007, projected savings for competitions completed are expected to generate approximately \$7 billion dollars in saving over the next seven to ten years. For competitions completed in Fiscal Year 2006 (FY06) alone, savings are expected to save \$1.3 billion dollars over the next five to ten years. Of the 183 competitions completed in FY 2006, Federal employees succeeded in winning a large majority – nearly 87 percent of the work competed.<sup>12</sup> While history has shown favorable results and large savings, all studies to this point have been based on US Government Appropriated Funded (APF) Entities, including those in the US Army. Most studies, when services or operations are contracted out, attribute savings to private corporations expertise, but also to not having to deal with the government bureaucracy, personnel system, and contracting, especially the Federal Acquisition Regulation (FAR). Army Lodging is not a US Government Appropriated Funded Entity, however, it is a Non-appropriated Fund Instrumentality (NAFI). All NAFIs fall under the NAF contracting and personnel systems. Both NAF systems are

far less restrictive than the APF system and allow operations to function in a business-like manner where many are profitable self-supporting operations.

Over the past decade the Army has conducted privatization initiatives in Army Lodging on a small scale, and in Army Housing on a large scale. In the area of housing, the Army's Residential Communities Initiative (RCI) Army Family Housing (AFH) Privatization Program is the model that the PAL is attempting to build on. Privatization programs similar to the Army's RCI program are also being implemented across the other services. The DoD and Department of the Army (DA) goal was to eliminate all inadequate family housing in the U.S. by 2007 using a combination of: (1) traditional military construction; (2) Basic Allowance for Housing increases; and (3) privatization.<sup>13</sup> In 1996, the Military Housing Privatization Initiative Act provided the military services with the authorities to leverage scarce funds and assets to obtain private sector capital and expertise to operate, manage, maintain, improve, and build military housing in the U.S.

The Army's RCI privatization program is an essential element for solving Army's acute family housing problems. The program is dedicated to building quality residential communities for Soldiers and their families. RCI is built on partnerships with private sector developers who have the expertise, are innovative, and have a willingness to work collaboratively with key stakeholders to make RCI a success. Basically, all housing assets are transferred the developer who then constructs or renovates the housing. The developer is responsible for maintenance and repair, property management, etc., and receives' the occupants Basic Allowance for Housing (BAH) for providing this service. The RCI program has transferred Army housing assets to private

corporations on 45 installations, grouped into 35 projects, with over 88,500 housing units -- over 99% of the AFH inventory is in the United States.<sup>14</sup>

The U.S. Government Accounting Office reviews of the RCI program are mixed, but the program is still too new to show the long-term financial cost and effects of the program. Rental revenues and occupancy rates remain well below expectations which could lead to financial stress. Over a third of the 44 projects reviewed had occupancy rates below the projected 90%. To keep the projects financially viable the privatization partners have had to start renting to unaccompanied military personnel, military retirees, DA civilians and contractors, and in some cases, the general public. Continued financial stress could have an impact on the RCI partner's ability to maintain and renovate housing stock, or in the worst case financial failure.<sup>15</sup>

On the Army Lodging (transient housing) side of the house, competitive contracting has been conducted on a much smaller scale through Public Private Ventures (PPV). The Army has PPV lodging operations at Hunter Army Air Field, Fort Bragg, Fort Irwin, Schofield Barracks, and the United States Army Military Academy. The first four operations were constructed by private hotel companies and the Thayer Hotel at West Point was an existing structure that was renovated and enlarged by a private partner. The partners own and operate the facilities and provide income to the installation based on occupancy, room rates, etc., on a pre-determined formula. Room rates are constrained by local per diem and occupancy varies greatly. Currently, the corporations who own the Inn at Schofield Barracks and the Lodge at Fort Bragg have legal cases pending against the Army. Both cases focus on whether or not a certain level of occupancy was guaranteed or implied in the contract. In the case of the Thayer

Hotel, the partner has been unable to meet their debt service on a regular basis. In all cases the projects have done poorly and have not provided the income stream anticipated by the installations. Furthermore, the legislation that allows for PPV projects no longer covers lodging operations due to a reclassification of the Army Lodging program.

### Key Individuals and Institutions

The key individuals, institutions, and stakeholders responsible for the development and implementation reside both internally and externally with the government. Internally, they reside at all levels of the Department of the Army (DA) hierarchy, the Office of Budget and Management (OMB), and Congress. This paper focuses mainly on the Army hierarchy because once approved in the Army channels, OMB and Congress rarely stop actions on privatization efforts.

Externally, the key stakeholders are the hotel and commercial lending institutions. Both will have a large role depending on various courses of actions and final recommendation. Hotel corporations offer a number of services that could be utilized under all of the alternatives. Army lodging already contracts for some services, to include consulting, marketing, architectural, and engineering. In general, the large hotel corporations offer property, operational, construction, and project management services. In conjunction with the Army's Lodging Wellness Plan, demand, market, and facilities assessments have been completed on all properties by a third-party consulting firm. Assessments on facilities were based on bringing facilities up to the current lodging standards and adjusting inventories to meet 90% occupancy for official

travelers. Overall this represents an extremely attractive new market for the hotel industry.

The financial services industry will play a large role under various scenarios. The market heuristic that banks require for most hotel/motel debt is 40% equity in a project due to the higher than average risk associated with the industry. Currently, Army lodging has an in-house bond rating BBB+<sup>16</sup> and the authority to enter into commercial financial markets to borrow money to develop and renovate operations.

The hierarchy of the US Army and the decentralized nature in the way it operates and is funded makes the Army policy process extremely difficult. What is good for one department or agency is not always good for another. Figure 1, shows the organizational structure of the departments and commands that will have a major role in developing the final policy and absorb the impact of implementation. The organizations highlighted in yellow are the stakeholders at the various levels. It should be noted that the very nature of the Army structure with both civilian and military personnel is shown in the organizational structure. Basically all staff components answer to two leaders, one military and one civilian that further complicates the decision making policy process (see Fig 1).

The Secretary (SA) and Assistant Secretaries of the Army (ASA) constitute the senior civilian leadership level of the Army in accordance Title 10 of U.S. Code.<sup>17</sup> The SA has ultimate responsibility for the well being of the troops to include housing. The SA relies on the ASAs to focus and operate various staff functions of the Army. The primary point person for this initiative is ASA for Installations and Environment (ASA-I&E).

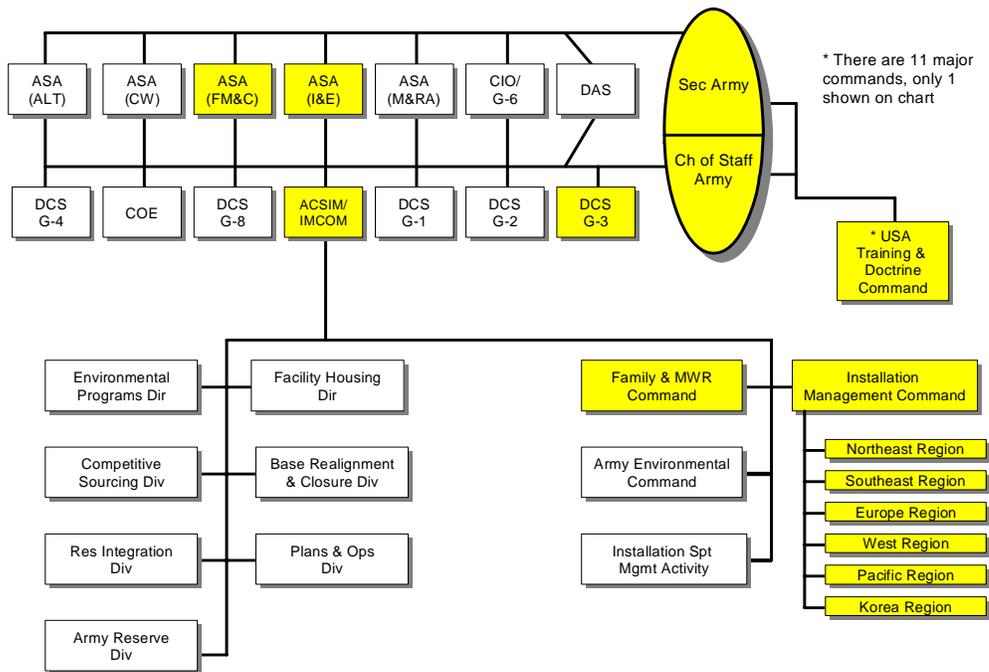


Figure 1 – Army Stakeholders in Policy Process<sup>18</sup>

The Office of the ASA-I&E has responsibility for policy development, program oversight and coordination of a wide variety of Army activities to include housing and lodging. Within the ASA I&E is the Deputy Assistant Secretary of the Army office for Privatization & Partnerships (DASA-P&P) which manages the RCI Program and PAL initiative. DASA-P&P will be the primary architect of the policy and is the gatekeeper of the information flow between internal and external organizations, the Army and Congress. ASA-I&E also co-chairs the Installation Program Evaluation Group (PEG) of the Army Planning, Programming and Budgeting System (APPBS) for inclusion to Program Objective Memorandum (POM) that sets funding for various installation programs.

In addition to the ASA-I&E, the Assistant Secretary of the Army Financial Management & Comptroller (ASA FM&C) is part of the decision making process. The ASA-FM&C exercises the comptroller functions of the Department of the Army and advises the Secretary of the Army on financial management. The Assistant Secretary's specific responsibilities are to direct and manage the Department of the Army's financial management activities and operations. They also provide recommendations on initiatives that will require Army funding. Any new large expense to the Army must be approved and funded by the ASA FM&C.

The Chief of Staff of the Army (CSA), Deputy Chiefs of Staff (DCS), Assistant Chief of Staff for Installation Management (ASCIM) / Commander, Installation Management Command (IMCOM) are the General Army Staff for the various functional offices that will have great influence in the decision making process on this initiative. The ASCIM and CG, IMCOM is a dual-hatted position. The CSA relies on the ACSIM to set policy for Army lodging. All base operations including housing and lodging fall under the ACSIM. The DCS for Operations (G-3) has the Army General Staff responsibility for all operational aspects of the Army to include overall force development, and individual and unit training policy. Approximately 85% of Army lodging occupancy is paid for by the G-3. The G-3 controls the funding for Army training through the travel and training account; therefore, they are the primary funding source for Army Lodging.

The Training and Doctrine Command is the largest customer of Army Lodging. By regulation, active duty soldiers on travel orders must stay in official government quarters (Army housing, barracks, or lodging) if it is available. The vast majority of Army Lodging is located on training installations, and there is a direct relationship between room rates

and how many Soldier the Army can train. The lower the room rate the more individuals the Army can train. "TRADOC recruits, trains and educates the Army's Soldiers; develops leaders; supports training in units; develops doctrine; establishes standards; and builds the future Army. TRADOC operates 33 schools and centers at 16 Army installations. TRADOC schools conduct 1,714 courses (187 directly in support of mobilization) and 391 language courses. The 1,714 courses include 451,682 seats for 399,406 Soldiers; 29,238 other-service personnel; 6,723 international Soldiers; and 15,827 civilians".<sup>19</sup> US Army Installation Management Command (IMCOM) and US Army Family and Morale, Welfare, and Recreation Command (FMWRC) are also key internal stakeholders. All housing and lodging facilities assets are under the purview, management, and operation of the IMCOM. FMWRC is the policy arm of the ASCIM for Army Morale, Welfare and Recreation (MWR), Family Programs, and Army Lodging operations worldwide. With respect to Army Lodging, FMWRC develops the lodging standards, and has oversight for the Lodging Wellness Program, Non-appropriated Fund Management, Lodging Construction, and central contracts.

### Lessons Learned<sup>20</sup>

The Center for Naval Analyses and the Institute for Public Research, a private, nonprofit research organization, conducted a number of studies to include; a study of 2,138 separate A-76 contracts completed by the DoD between 1978 and 1994, a study of the 210 DOD A-76 competitions completed between 1995 and 2000, a review A-76 competitions undertaken just within the Navy. The U.S. General Accounting Office (GAO) also conducted a study on 286 A-76 reviews it conducted between 1999 and 2000. Studies included all major department of the US Government and several key

themes contributed to the success or failure of the competitive process. The most important of these “Lessons Learned” are discussed and their relationship to the PAL process.

#### Successful Privatization Requires Dedicated Leadership

In previous initiatives leadership and resources were not always in place to ensure success. All successful privatization programs have at their helm an appointed official who considers privatization a priority, is willing to do battle with its traditional opponents, and is determined to persevere in the face of numerous obstacles and delays. The Army, in an effort to give visibility at the highest levels and have the power to implement programs, developed an office at the ASA I&E level to manage and implement privatization and partnerships.

#### Successful Privatization Requires Expertise in all Facets of the Partnership Agreement

In previous initiatives, especially the PPV dealing with Army lodging, contracts were signed that were not in the best interest of the Army, did not spread the market and financial risk between the partners, nor had proper limits for charges to the customers. In the past, the Army relied on in-house staff and limited consultant expertise to construct agreements and partnership contracts. Under the ASA I&E office, contractors provide expertise in all areas of the partnership contract to include finance, legal, property management, real estate partnerships, construction, and other areas pertinent to the success of the program. Through the RCI model, financial risk has been diverted to lending institutions, legal entities (limited liability corporations) have been set up for each partnership, and checks and balances have been put in place to reduce risk in all areas of the contract.

## Successful Privatization also Requires that Proponents of Reform Defuse the Opposition

Even with dedicated leadership, privatization efforts will fail if leadership ignores the concerns of opponents, however frivolous or selfish those concerns may seem.

As the record of the past two decades demonstrates, the programs that succeed are the ones that are open to compromise and accommodate the concerns of existing and potential opponents, especially those who want to maintain the status quo. In this regard, it is essential for reformers to view any act of privatization as a political act with economic consequences, never the other way around. Privatization efforts that focus only on the technical gains in cost efficiencies and service improvements, to the exclusion of other considerations, reflect an economic act with political consequences, and those political consequences invariably will be damaging.<sup>21</sup>

Therefore, it is imperative that all privatization efforts identify potential opponents, their concerns, and the political impact the decision will have on the organization and other stakeholders. To merely focus on cost saving and not the political ramifications will slow down the process or stop it completely.

## Privatization Requires Effective use of Legislative Vehicles

For years, opponents who want to prevent privatization have often used the legislative process, particularly the appropriations process that funds the programs and agencies. By learning from these defeats, proponents have discovered that the same legislative vehicles and techniques can be used in support of privatization. The Congress and the military used the legislative process to ensure the initiative would not be slowed down or blocked by current laws. In 1996, the Military Housing Privatization Initiative Act (MHPI) provided the military services with the authorities to leverage scarce funds and assets to obtain private sector capital and expertise to operate, manage, maintain, improve and build military housing in the U.S. MHPI also exempts

housing initiatives from the A-76 process for contracting out commercial activities, thus, installations cannot bid on partnership. While this clause had little or no impact on large housing projects, it has great impact on single lodging operations. In February 2004, the Office of the General Counsel of the Army ruled that lodging operations could be considered housing under the MHPI Act, paving the way for PAL to proceed unimpeded.

### Organizations Should Never Lose Control over the Outsourced Activity

It is imperative that organizations outsource for the right reasons and not based on poor performance when the activity is key and essential to the overall operation. “When the performance quality of an activity is low, managers are often tempted to outsource it. If poor performance is attributable to factors such as insufficient scale economies or a lack of expertise, outsourcing makes sense. If poor performance is attributable to poor management, outsourcing is not necessarily the right solution.”<sup>22</sup> In the case of privatization, the government will lose control over the management of the operation and the assets. If privatization fails, the cost to bring operational management and assets back under the control of the government may be cost prohibitive.

### Lodging Economics

In order to make the informed decision on Army lodging and avoid the mistakes that led to the deterioration of the infra-structure, it is important to understand how the program is funded and why facilities are in their current condition. The lodging program is authorized 100% appropriated funding (APF) and is supplemented with non-appropriated funding (NAF) through collection of room charges from occupants. As

stated earlier, Army lodging is a separate NAFI, therefore, its NAF funds are fenced in a separate account and the profits can only be used in lodging operations.

Until 1998, the Army DPW engineers at the installation level managed lodging operations, with no overall plan to fund the aging infrastructure. Individual operations developed plans to repair and renovate their operations and incorporated that cost into their room rate. There were a number of problems with this mode of operation: (1) installation level lodging management lacked the education and skills in most cases to develop long-range plans; (2) engineers focused their APF resources on base operations and lodging usually only received APF for utilities; (3) room rates were set at a local level based on the government per diem rates and in accordance with Army Regulation 210-50 were set at or below 50% of the government per diem rate (exception to policy was needed to go above this rate); (4) most installations fall under the general per diem rate currently set at \$70 for lodging.

In 1998, lodging operations and policy were moved from the engineers to the FMWRC (formerly CFSC) and subsequently Army Lodging officials developed the Army Lodging Wellness Plan. The Wellness Plan instituted standards for service, operations, facilities, and developed a construction program to bring all facilities up to these standards.<sup>23</sup> During FY06, Army Lodging operations at 79 garrisons offered 19,557 rooms to 6.3M travelers, 91 percent of whom were on official orders for Temporary Duty or Permanent Change of Station. With an Army-wide weighted average daily rate per room of \$40.14, Army Lodging saved the Army \$180M in official travel dollars and saved space-available travelers \$18M in comparison to local lodging per diem rates. Occupied room nights numbered 5.1M, for a 71.4 percent overall occupancy rate and

total lodging program operating revenues of \$215M. Revenues supported \$138M in operating expenses, \$13.3M in local capital purchase and minor construction, and \$48M to invest in facility renovation and new construction through the Army Lodging Wellness Program. The Wellness Program developed a clear framework, standards, process and funding source needed to support maintenance, renovations, and new construction.<sup>24</sup>

### Alternatives

In order to evaluate the best course of action for the government to operate Army Lodging in an effective and efficient manner the various options need to be defined. The list below consists of four alternatives that represent typical methods in the lodging industry for management operational structure.

#### Status Quo – Continue With the Current Lodging Wellness Plan

The Lodging Wellness Plan was developed and implemented to bring all facilities up to a standard and maintain that standard in the future. The plan covers replacement and/or renovation of all infrastructures, standards for service, operations, and facilities. Complete analysis by an independent engineering and marketing firm (3DI Inc.) was completed in FY 05 for all facilities. This analysis is being utilized by both FMWRC and the ASA I&E office for the basis of the privatization initiative. The analysis was based on a market demand or rightsizing the room inventory to meet 90% of the official historical demand to include statements of non-availability to official travelers.

Structural and engineering analysis was based on adjustments to room inventories and building conditions. If the cost to bring the facility to the lodging standard is below 50% replacement cost, the facility will be renovated; above 50%, it will be replaced by new construction, the cost to implement plan by building by installation. The analysis

developed the marketing mix on the number of rooms and types needed in the inventory to meet clientele's needs. There are three standard room designs; standard guest room, extended stay, and family suites. The analysis and subsequent plan developed by 3DI will be utilized as the basis for all alternatives in this policy paper.

To finance the plan the Army instituted a Lodging Capital Assessment (LCA) in FY 01 on every room night. The LCA (currently \$12) was added to the room rate and goes directly to the construction fund. In addition to the closure of facilities under 25-rooms, demand assessments will reduce room inventory to 90% of official demand. The two actions will reduce the room inventory by approximately 2,000 rooms. The LCA was capped by the 4-star general MWR Board of Directors at 12 dollars per room night. Under the current backlog of projects, completion of the "Lodging Wellness Plan" is estimated in 2023. The Wellness Plan currently has approximately \$48 million in ongoing new construction projects scheduled renovations. New facilities recently completed include a 95-room (\$17.2M) lodge at Ft. Wainwright, Alaska, 300-room (\$28.5M) lodge at Ft. Eustis, Virginia, a 46-room (\$8.3M) lodge at Fort Hamilton, New York, and a 50-room (\$9.3) lodge at Camp Carroll, Korea. The Army lodging program also has the ability to borrow money on the open market, finance debt, leverage capital, and currently has a bond rating of BBB+. The Army owns and operates a number of recreational lodging facilities around the world that maintain occupancy in high 90% and are very profitable that are not part of official lodging. Most notable are the 600-room Shades of Green Hotel in Disney World, the 660-rooms oceanfront Hale Koa Hotel in Hawaii, and the 350-room Dragon Hill Lodge in Seoul, Korea, and the new 200-room operation Edelweiss Lodge recently opened in Germany this year. The expansion in

the Disney property and the German facility were both debt-financed giving the Army a precedent for using debt to finance construction.

The status quo alternative will improve the lodging to the standards, eliminate inadequate facilities, and is very flexible for local commanders. It fails to resolve issues of reducing the plan by 9 years, improving management skills of lodging personnel, transferring non-core function to the private sector (under A-76 guidelines), and meeting short-term goals of the Army.

#### Privatization of Army Lodging – Totally Privatize and Divest All Lodging Assets

Under the PAL model the timeline will be reduced to 2014. Under this model a public partner will own and operate all transient lodging on Army installations, total divestiture and privatization. The Army would maintain a headquarters staff to oversee the contracts, be liaisons between the installation and the partnership, provide some asset management, and for audit purposes. This model does not cover Europe, Korea, or Japan. Under the current structure, Army lodging does not pay rents or mortgages, debt service, taxes (corporate and occupancy), utilities, and some maintenance and repair. Nor does it have to make a profit or pay dividends to stockholders. Lodging's sole financial purpose is to maintain operations to standards and cover operating expenses. Under privatization, Army lodging will be owned and operated like any other local commercial hotel and cannot be afforded any unfair competitive advantage, therefore, it will no longer be official lodging for the Army. This change is significant in two ways. First, active duty soldiers will no longer be required to stay in Army Lodging. Second, installation commanders will no longer be able to convert lodging facilities to barracks during large troop movements.

The RCI model will transfer ownership of all current assets (new and old) to a commercial public partner at no cost and lease the land at minimal cost. Not all facilities are in poor condition, with 35% having been built in the last 14 years. The Army will be giving away over \$3 billion in assets. The partner will be required to bring all facilities up to the lodging standards based on the 3DI plan by 2014. All current working capital projects will remain in place and be transferred to the partner upon completion.

Under a partnership agreement, it is estimated that the partner will need to bring 30% equity of the regional project cost to the table and the rest of capital needed will be done through debt financing with an estimated interest rate of 7-8%. Occupancy taxes are local taxes and usually range from 10-15%. Relief from these taxes will be sought on an operation-by-operation basis, but in most cases it is doubtful relief will be granted.<sup>25</sup> Relief from local occupancy tax would give a private partner an advantage over other commercial operators outside the installation boundaries, and since occupancy taxes are collected from individuals living outside local jurisdictions, there is little incentive to waive this tax. Utilities will be the responsibility of the partner and will add between \$4 and \$4.50 per room night based on location of the installation. A 20% profit margin for the partner and a 10% capital reinvestment fund were also added to the model. The 10% capital reinvestment fund will be required for all alternatives to ensure infrastructure degradation does not occur in the future. In order to accommodate the additional expenses and still deliver a 20% profit, the room rate will need to rise from its current 45% of per diem to 75-80%. This translates into an additional burden on the APF Travel and Training Accounts that will rise as each additional regional partnership goes into effect. This burden upon completion in 2014 is estimated at \$200 to \$225

million annually in today's dollars. It will be the responsibility of the ASA-FM&C to get the additional funding into the POM.

The PAL model will bring lodging up to standard and reduce the wellness timeline to 2014 pending increases to the Travel and Training Accounts. It should be noted that the PAL timeline has 3 years from 2011 to 2014 since the initiative started. The first contract was let under the PAL model in 2006 for 13 garrisons. Actus Lend Lease LLC, Nashville, Tenn., recently won a bid with the Army that would give it long-term ground leases and 48 existing hotel properties on 13 military installations in exchange for running and upgrading the facilities. Actus, a military-housing subsidiary of retail- and residential- property company, Lend Lease Corp. of Australia, is bringing in InterContinental Hotels Group PLC (IHG) of London as its partner to manage the hotels, which will be branded with IHG names such as Holiday Inn Express, Staybridge Suites or Candlewood Suites. "Actus will finance the lodging renovation and new construction by borrowing against the cash flow the hotels generate. More than 98% of the cash flow from the hotels will be reinvested. Actus makes its money from construction and development fees, as well as a return on the equity it invests in the hotels. Under terms of the Army deal, Actus can take an equity stake worth 2% to 5% of development costs, and its returns are capped at 14% to 20% on that equity, he says. IHG will make money from management fees, which typically are about 6% to 8% of hotel revenues."<sup>26</sup>

#### Modified Lodging Wellness Plan – Use Current Plan and Restructure Financing Options

This alternative is a modified approach to the current Army Lodging Wellness Plan discussed under the status quo alternative. The main criterion that is not met in the first option is reducing the timeline to bring all operations up standard by 2014. Under the

privatization model, room rates will rise to 75-80% of per diem to reduce the timeline to 2014 and the partner needs to invest 30% equity in the partnership. Under the PAL Model, of the 90-100% room-rate increased cost to the Army, only a portion will go to construct and renovate facilities, and the increase will go on in perpetuity. Only about 50% of the additional room charge increase will go to construction, the rest will cover taxes, debt service, profits, etc. If the operation was kept in-house, and the room charges were increased to 80% of per diem, the same, as under the privatization concept, Army Lodging would meet the 2014 timeline. Under this alternative all of the increased room charge would be funneled into the construction fund in addition to the approximately \$45.3 million already coming in from the Lodging Capital Assessment annually. After build out, room rates would decrease to 45% of per diem rate, which would include the 10% capital expense and the LCA to ensure infrastructure is maintained in the future. This alternative will meet all of the criteria except improvement of the management skills and the transfer of non-core functions.

#### Hotel Management Contract (HMC) – Army Continues to Own the Assets and Outsources Operational Management

Under this alternative, property, operational, project and construction management for all lodging facilities would be done under a management contract. The Army would develop and implement a strategic partnership with a national hotel corporation, similar to the arrangement of Actus and IHG. The Army would maintain a headquarters staff to oversee operations, asset management, auditing, contract review, financial management, budgeting, and strategic planning and management. The Army would continue to own the assets and would raise room rates to the 75-80% per diem rate to fund the construction program. This would require a change to policy and adequate

funding in the travel and training accounts to offset the increase. After build out in 2014, the rates would decrease to approximately 55% of per diem to cover the management fees. According to a recent study, the average base fee (the part of the management fees that is calculated as a percentage of turnover) is 1.8 percent of gross revenue and the average incentive fee (the part of the management fees that is calculated as a percentage of profit) is 6.9 percent of gross operating profit. Today it is an established principle of the international hospitality industry that ownership and operation of a hotel are more often than not separated.<sup>27</sup> Under this alternative, Army lodging would gain the expertise and skills needed to improve management while maintaining the flexibility needed to respond to the needs of the Army.

#### Selection Criteria for Analysis will be Based on

In order to evaluate the various lodging management operational structures, evaluation criteria was developed based on the analysis of the current state of Army Lodging, the need to bring facilities up to or surpass Army Lodging managerial, operational, and facility standards, solve the funding shortfall, maintain flexibility, and be the best use of tax dollars. Criteria were developed based on the current literature and analysis by the author.

- Meeting Army lodging standards worldwide. Companies that are able to execute this type partnership are large international firms with worldwide operations. These firms have international offices and relationships that will enable them to get facilities up to the lodging standards in an expedited manner. Privatization does not address overseas operations and the other two in-house alternatives do not have the worldwide network to plan, design, construct, and

maintain multiple projects. While the Army Lodging office oversees construction projects now, design and construction are contracted out through the bid process and in-house construction and contracting assets will not be able to meet the aggressive construction program over the next 6-7 years.

- Eliminate inadequate on-post lodging facilities and right-sizing the operations.

All alternatives will be able to meet this selection criterion based on varying timelines.

- Solving the funding dilemma. While the status quo options would have the least impact on funding through the continuation of the LCA to fund the construction program, the program cannot wait the additional 9 years to complete. The other three options raise the room-rate to the 75-80% level to fund the construction program, which will need to be covered in the travel and training accounts through the POM process. Whereas, the HMC and the Modified Lodging Wellness options decrease the room rate once the construction program is completed, the PAL model will continue at the increased rate in perpetuity. This additional expense is estimated at \$180-200 million in today's dollar, and after 2014 will continue to rise by at least the inflation rate and contract incentive increases making it the least desirable in this area.

- Improve the efficiency and skills of Army lodging management. The Army has an extensive training program that includes local training through the Hotel/Motel Management Association's Performance-Plus Program, 12 courses per year at Penn State University's School of Hotel Management, and national and local training conferences. Even with this training program, the skill level of Army

lodging management is still well below the industry mainly due to our structure. Financial and program management resides with FMWRC's Army Lodging Division (16 people). Operational management resides with 7 regional managers attached to IMCOM regional offices, and general managers at each operation. Local general managers work for installation commanders and not regional managers. Regional managers work for a regional director and not the HQ IMCOM program manager, and none of the managers at each level works for FMWRC. Trying to get a well-structured corporate management structure in place that promotes top managers, terminates poor performers, oversees operations, training and makes quick and binding decisions is impossible under the current structure. One of the best ways to get a corporate structure is to move it out of the Army command structure, and both the PAL model and HMC option will accomplish this.

- Execute the President's Management Agenda through the transfer of non-core functions to the private sector when it provides the best value. Both the PAL Model and the HMC alternatives transfer the function of operating Army lodging to the private sector. Under both options the Army would maintain a headquarters staff to oversee operations, asset management, auditing, contract review, financial management, budgeting, and strategic planning and management. The PAL model transfers the function to the private sector it is also the highest cost alternative to the tax payers.

- Decrease the current timeline under the Lodging Wellness Plan from 2023 to 2014. The status quo option is the only one that will not meet this criterion.

- Maintain flexibility to accommodate large troop mobilization/demobilization during times of conflict. Lodging operations are official housing of transient soldiers, during times of high troop movement lodging facilities are diverted to barracks and used to house soldiers. Keeping operations totally in-house under the Status Quo and Modified Lodging Wellness Plan alternative offers the greatest flexibility, and just the opposite is the case under the PAL Model. It is not unusual during mobilizations, de-mobilization, medical recuperation, and other actions that lodging facilities are diverted to barracks. Lodging facilities that typically house 200 soldiers during normal times might increase to 500 soldiers, with soldiers in any space available including rooms, hall, lounges, etc. In FY 04, this occurred on 7 installations. The other issue is Base Realignment and Closure (BRAC), once a private partner invest substantial amounts of money into an installation and the Army closes the installation, the partner will require reimbursement. Under the HMC option these details can be incorporated into the management contract.

- Must be economically feasible to implement and create best use of taxpayer dollars. The PAL Model option will increase the cost of providing the service to the Army substantially. While the two in-house options are both economically feasible, the expertise and substantial track record of the hotel partner should provide considerable savings in the long run.

	Meeting Army lodging standards worldwide	Eliminate inadequate on-post lodging facilities or right-sizing the operations	Solving the funding dilemma	Improving the efficiency and skills of Army lodging management	Execution the President's Management Agenda through the transfer of non-core functions to the private sector when it provides the best value	Decrease the current timeline under the Lodging Wellness Plan from 2023 to 2014	Flexibility to accommodate large troop mobilization/demobilization during times of conflict	Must be economically feasible to implement and create best use of taxpayer dollars	Average Score
<b>Alternatives</b>									
Status Quo	3	4	5	1	1	1	5	4	3.00
Privatization of Army Lodging	2	4	2	5	4	4	1	2	3.00
Modified Lodging Wellness Plan	3	4	4	1	1	4	5	4	3.25
Hotel Management Contract	4	4	4	5	5	4	3	5	4.25

1 = Least effective and efficient method to meet goal  
2 = Somewhat effective and efficient method to meet goal  
3 = Average effective and efficient method to meet goal  
4 = Very effective and efficient method to meet goal  
5 = Most effective and efficient method to meet goal

Table 1: Effectiveness and Efficiency of the Alternatives based on Selection Criteria

Based on the result of the alternatives analysis, the strategy of the Hotel Management Contract presents the most effective approach to achieving the objectives of the Army and the PMA. It combines the best of both government and public resources, resolves the issues of poor management, and transfers the non-core function to the private sector while remaining flexible to meet the changing needs of the Army.

## Conclusion

In order to accomplish the President's Management Agenda, the directives of the Department of Defense, and meet the needs of the Army, the lodging program must make a fundamental change in how it does business. There has been a shift in demand for Army funding due to the increased operations to fight the Global War on Terrorism and the transformation from a Cold War Army to a quick strike modular force. Dwindling funds for many programs have created the need to become more efficient and effective in managing and operating facilities. Analysis of the Army Lodging Program indicated a need to become more efficient and the overall program was a good candidate for divestiture and to be privatized. Under the analysis conducted in this paper, the alternative of total privatization proved not to be in the best interest of the Army due to increases in cost to provide the service, cost of divestiture, and loss of flexibility. The hybrid approach of outsourcing the operational management, asset management, and construction project management was deemed to provide the best value for the government and resolve all pertinent issues with the least disruption of the service. This alternative kept the program flexible to meet the needs of the Army, controlled the cost to operate the program, and gained the skills and management expertise needed to improve the program and effectively implement the Lodging Wellness Program. This new direction must be at the direction of the Assistant Secretary of the Army for Installation and Environment and should be developed as the model for DoD.

To implement the Hotel Management Contract (HMC) and outsource the operational management, project development, construction management, and asset management of Army lodging at installations, the Assistant Secretary of the Army for Installations and Environment in conjunction with the Chief of Army Lodging will need to

start the process using a Request for Qualifications (RFQ) solicitation process. The Army will employ the RFQ process to identify the best value partner who will, in collaboration with the Army, create a Lodging Development and Management Plan (LDMP) that applies to the lodging assets at the installations. The Army will implement the LDMP with the best value partner subject to satisfaction of certain milestones and hurdles identified in the RFQ. The HMC seeks to apply the best practices of the private sector to achieve improved Army lodging. Prospective companies can be single companies, joint ventures, or partnerships, no matter what the organizational form is, requested information must be submitted for all entities. The RFQ process will identify the best value offeror determined to be the most highly qualified to enter into a long-term business relationship with the Army to upgrade, operate and maintain transient lodging at all of the installations identified by the Army. Selection will be based upon the qualifications of the offerors as outlined by the evaluation factors and upon the basis of best value to the government.

In order for the Army to be good stewards of taxpayer dollars, operate their lodging facilities in an effective and efficient manner, and maintain the flexibility needed in today's complex environment, it is imperative that the Assistant Secretary of the Army for Installations and Environment re-analyze the position on privatizing Army Lodging.

### Endnotes

<sup>1</sup> "Information Paper: Residential Communities Initiatives," May 2007, linked from *Office of the Assistant Secretary of the Army for Installations and Environment Home Page*, available from <http://www.rci.army.mil/programinfo/infopaper.html>; Internet; accessed 12 December 2007.

<sup>2</sup> George W. Bush, *The President's Management Agenda* (Washington, D.C.: The Executive Office of the President, Office of Management and Budget, Fiscal Year 2002), 11-30; available from <http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>; Internet; accessed 30 October 2007.

<sup>3</sup> Office of Management and Budget, Circular No. A-76 (Revised) (Washington, D.C.; 29 May 2003). OMB Circular A-76 states that, in the process of governing, the Government should not compete with its citizens, and where possible, the Government will rely on commercial sources to supply the products and services the Government needs. A *commercial activity* is one which is operated by a Federal executive agency and which provides a product or service that could be obtained from a commercial source. Activities that meet the definition of an inherently Governmental function not commercial activities. An *inherently Governmental function* is a function which is so intimately related to the public interest as to mandate performance by Government employees.

<sup>4</sup> Carl D. DeMaio, Adrian Moore, and Vincent Badolato, *Designing a Performance-Based Competitive Sourcing Process for the Federal Government* (Los Angeles, CA: Reason Foundation, October 2002), 4; available from <http://www.reason.org/ps299.pdf>; Internet; accessed 12 December 2007.

<sup>5</sup> Christopher Lee, "Civilian Workers' Fight to Keep Pentagon Jobs Backed," *The Washington Post* 26 September 2003, A.25 [database on-line] available from ProQuest; accessed 10 October 2007.

<sup>6</sup> Jerome Baitheimy, "The Seven Deadly Sins of Outsourcing," *Academy of Management Executive*, 17, no. 2 (2003): 92.

<sup>7</sup> U.S. Department of Defense (DoD), *Lodging Policy*, DoD Instruction 1015.11, (Washington, D.C.: U.S. Department of Defense, 6 October 2006), 2-7; available from <http://www.dtic.mil/whs/directives/corres/pdf/101512p.pdf>, Internet; accessed 12 December 2007. TDY Lodging: Transient Unaccompanied Personnel Housing (TUPH). TUPH or official travel quarters are a primary source of quarters for TDY personnel and should be used if the quarters meet mission requirements and are available. These activities operate as a separate fund normally called a Lodging or Billeting fund, independent of the single MWR fund. Facilities are built, leased, acquired, maintained, managed, and operated primarily with APF (or contracted or acquired through APF contracting process) for patrons who are in a non-duty or leave status and other authorized patrons; TDY personnel have priority use. PCS Lodging: Temporary Lodging Facilities. When such facilities are built and maintained or operated by other than the MWR program or exchange service, they shall be a separate fund, designated as a Lodging or Billeting fund, independent of the single MWR fund. These facilities may be jointly operated within a Lodging or Billeting fund to gain operational economies, efficiencies and savings.

<sup>8</sup> Ryan Chittum, "Army Taps Private Sector to Oversee Lodging; About One-Third of Hotels Are Set to Be Privatized In Bid to Upgrade Facilities," *Wall Street Journal*, 25 October 2006, B 4 [database on-line]; available from ProQuest; accessed 10 October 2007.

<sup>9</sup> Ronald D. Utt, *Improving Government Performance Through Competitive Contracting*, (Washington, D.C.: Heritage Foundation, 25 June 2001), 1; available from [http://www.heritage.org/Research/GovernmentReform/upload/7896\\_1.pdf](http://www.heritage.org/Research/GovernmentReform/upload/7896_1.pdf); Internet; accessed 10 October 2007.

<sup>10</sup> Chet Dembeck, "Army Lines Up Private-Sector Partnerships: Service Projects \$600 Million Savings," *Federal Times*, August 26, 2002. [database on-line]; available from ProQuest; accessed 10 October 2007.

<sup>11</sup> Utt, 4.

<sup>12</sup> "Information Paper: Residential Communities Initiatives," May 2007

<sup>13</sup> Ibid.

<sup>14</sup> Ibid.

<sup>15</sup> U.S. Government Accountability Office, *Military Housing: Management Issues Require Attention as the Privatization Program Matures* (Washington, D.C.: U.S. Government Accountability Office, April 2006), 4; available from [www.gao.gov/cgi-bin/getrpt?GAO-06-438](http://www.gao.gov/cgi-bin/getrpt?GAO-06-438), Internet; accessed 25 September 2007.

<sup>16</sup> "Information Paper: Standard & Poor's Ratings Definitions," 17 March 2007, linked from *Standards and Poors Ratings Home Page*, available from <http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,1,4,1204834067208.html#ID213> Internet; accessed 16 October 2007. Issue ratings are an assessment of default risk, but may incorporate an assessment of relative seniority or ultimate recovery in the event of default. An obligor rated 'BBB' has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments. The ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

<sup>17</sup> *Armed Forces United States Code Title 10*, available from [http://www.law.cornell.edu/uscode/10/usc\\_sup\\_01\\_10.html](http://www.law.cornell.edu/uscode/10/usc_sup_01_10.html); Internet; accessed 12 December 2007. Title 10 provides the legal basis for the roles, missions and organization of each of the services as well as the United States Department of Defense.

<sup>18</sup> "HQDA Staff," linked from *U.S. Army Home Page*, available from <http://www.army.mil/organization/hqdastaff.html>; Internet; accessed 16 October 2007.

<sup>19</sup> "About TRADOC," linked from *U.S. Army Training and Doctrine Command Home Page*, available from <http://www.tradoc.army.mil/about.htm>; Internet; accessed 12 December 2007.

<sup>20</sup> Ronald D. Utt, Lessons learned were based on a number of studies conducted by the CNA Corporation and the U.S. General Accounting Office (GAO). The CNA Corporation (CNAC) is a non-profit research organization that operates the Center for Naval Analyses and the Institute for Public Research. The CNA Corporation, a private, nonprofit research organization, conducted a number of studies to include; a study of 2,138 separate A-76 contracts completed by the DOD between 1978 and 1994, a study of the 210 DOD A-76 competitions completed between 1995 and 2000, a review A-76 competitions undertaken just within the Navy. The U.S. General Accounting Office (GAO) conducted a study on 286 A-76 reviews it conducted between 1999 and 2000. Studies included all major department of the US Government.

<sup>21</sup> Carla Tighe et al, *Outsourcing and Competition: Lessons Learned from DOD Commercial Activities Program*, Center for Naval Analysis Occasional Paper, Alexandria, VA: Center for Naval Analysis (October 1996), 7.

<sup>22</sup> Baitheimy, 92.

<sup>23</sup> "Lodging Standards," linked from *U.S. Army Family and Morale, Welfare, and Recreation Home Page*, available from [http://www.armymwr.biz/lodging\\_standards.htm](http://www.armymwr.biz/lodging_standards.htm), Internet; accessed 10 November 2007.

<sup>24</sup> "FY 06 Annual Report," linked from *U.S. Army Family and Morale, Welfare, and Recreation Home Page U.S. Army FMWRC FY 06 Annual Report*, available from [http://www.armymwr.biz/annual\\_report.htm](http://www.armymwr.biz/annual_report.htm); Internet; accessed 12 Dec 2007.

<sup>25</sup> "PAL Overview Briefing," linked from *Office of the Assistant Secretary of the Army for Installations and Environment, Privatization and Partnership Home Page*, available from <http://www.pal.army.mil/documents/PAL%20Overview%20Briefing.pdf>; Internet; accessed 12 December 2007.

<sup>26</sup> Chittum.

<sup>27</sup> Robert Schlup, "Hotel Management Agreements: Balancing the Interests of Owners and Operators," *Journal of Retail & Leisure Property*. 3 (April 2004): 331 [database on-line]; available from ProQuest; accessed 10 October 2007.