

# Squeezing Value Out of Idle Assets: Enhanced Use Leasing in the U.S. Army

While the U.S. Army has implemented enhanced use leases to its great advantage, it must overcome substantive challenges if it is to continue to benefit from this unique authority.

BY DAVE ANDERSON

The September 6, 2001, *USA Today* carried the following feature headline: “USA’s Military Bases Turning Into Slums.” The accompanying article led with the following vignette:

Chief Warrant Officer Butch Zirpolo’s soldiers are proud to maintain the world’s most advanced combat helicopter, the Longbow Apache. They just wish they didn’t have to work in such a decrepit hangar. The cavernous structure was built nearly 50 years ago for massive B-52 bombers. It has no insulation, the roof leaks, and windows are missing. The light fixtures are so high that maintenance crews have to use flashlights to work at night. And rotor blades have been damaged repeatedly as the helicopters maneuver around motorized bay doors that keep breaking down. The rotors cost \$100,000 to replace... Welcome to today’s U.S. military, where rundown housing and ramshackle work facilities are common on bases across the country.<sup>1</sup>

The army of the richest nation on earth was living and working in impoverished conditions. How in the world could this have happened? Was there anything that could be done to make a quick difference?

The U.S. Army owned thousands of acres of land and hundreds of facilities that were unused, yet not considered “excess” to the Army’s needs. A 2008 U.S. Government

Accountability Office report cited many possible explanations for this apparent inconsistency:

Land, buildings, and facilities on DOD [U.S. Department of Defense] installations may appear underutilized or not utilized, but are nonetheless unavailable for other uses for several reasons. Restrictions and constraints on DOD’s use of lands under its control include setbacks for antiterrorism protection, mission requirements, necessary safety zones, and environmental considerations. In addition to underutilized

## About the Author

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land, buildings and facilities on DOD installations may appear underutilized or not utilized because of historical considerations, the need to make room for incoming personnel, or the need for repair or demolition funding.<sup>2</sup>

Many of these unused, “non-excess” properties had a great deal of economic value to the private sector, yet the military services lacked the authority to lease them for any longer than five years. With no large-scale budget increases on the horizon, some in the government believed there might be a way to squeeze value out of these assets and use the proceeds to help rejuvenate the Army’s infrastructure.

In the late 1990s, the U.S. Department of Defense (DOD) asked Congress for the authority to enter into long-term lease agreements with private entities for land that was unused, yet not excess to the installation’s needs. These leases, referred to as “enhanced use leases” (EULs), were designed to provide DOD installations with significant off-budget funding relief from their infrastructure woes.

### Crisis Brings Opportunity: The Genesis of EUL Authorities

By the end of the 1990s, U.S. Army installations had deteriorated to alarming levels. Roofs leaked, paint was peeling, grass was mown infrequently, pipes dripped, and toilets and urinals would not flush properly. Soldiers and their families lived in cramped and dilapidated quarters. Army staff worked in broken-down motor pools intended to maintain fleets of vehicles that had long since been replaced. The Army’s maneuver and live-fire ranges had not been modernized to keep up with new weapons systems. Barracks which served as the home of 40 to 50 percent of the enlisted population of the Army were described as recently as 2001 as “slums.”<sup>3</sup> The moniker was well-earned, but these awful conditions did not come about by accident.

The end of the Cold War brought a decision to significantly reduce the nation’s investment in defense. The Soviet Union had collapsed and there were no near-peer military competitors on the horizon. It seemed like a good time to bring down defense spending and redirect the nation’s wealth to domestic programs. From the end of the Cold War in 1989 to the beginning of the Global War on Terror in 2001, the nation reduced its spending on defense from 5.6 percent to 3.0 percent of the gross domestic product (GDP) (see FIGURE 1 on page 141). This represented a constant dollar reduction in defense investment from \$564.8 billion in 1989 to \$367.3 billion in 2001.<sup>4</sup>

The DOD procurement holiday of the 1990s was accompanied by a DOD infrastructure improvement holiday. From 1989 to 2001, DOD reduced spending on military construction from \$8.3 billion to \$6.2 billion, and also reduced its investment in the construction and maintenance of family housing from \$4.74 billion to \$4.17 billion.<sup>5</sup> This funding reduction exacerbated the rate of decay of the Army’s posts, camps, and stations. Funds needed to accomplish critical repairs and to perform preventative maintenance were not available.

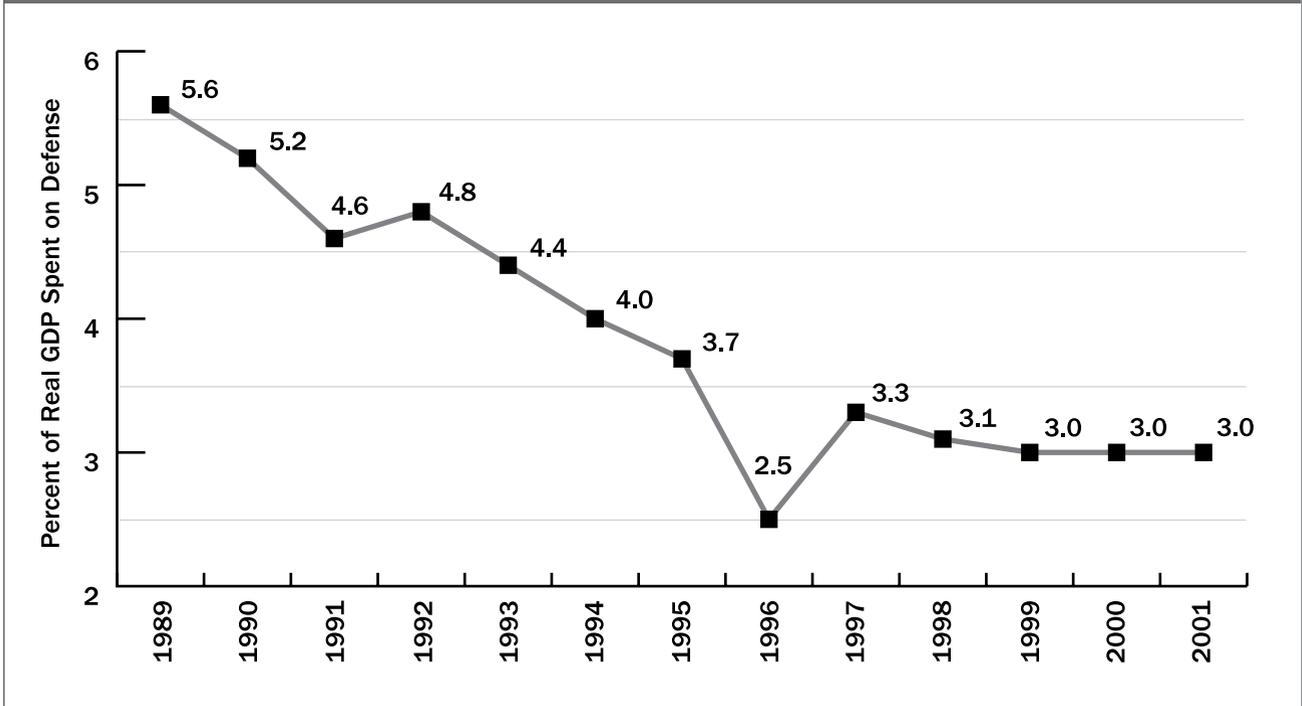
The list of unfunded maintenance projects grew into a massive backlog that eventually reached an estimated \$60 billion across the entire DOD.<sup>6</sup> By fiscal year 2000, the Army owned \$27.4 billion of that backlog, which was growing at a rate of over 13 percent per year.<sup>7</sup> (See FIGURE 2 on page 142.)

The desperate state of decay of Army installations could also be measured by the service’s *recapitalization rate*, defined as the “rate at which facilities are renovated or replaced in order to support mission requirements.”<sup>8</sup> While the private sector replaces or modernizes facilities at an average rate of once every 57 years, DOD’s objective was to recapitalize its facilities every 67 years. Shockingly, the 2001 Quadrennial Defense Review projected that at the current investment rates, DOD would only be able to recapitalize its facilities every 192 years.<sup>9</sup>

A 2001 report found that the Army’s facilities were “in a death spiral”<sup>10</sup> that would take 30 years to reverse. “You can’t neglect their infrastructure for this long without having to sooner or later pay the piper. That where we are today,” said then-Major General Robert van Antwerp, the Army’s assistant chief of staff for installation management.<sup>11</sup> Something had to be done very quickly to reverse this dangerous trend.

While it recognized the crisis at hand, DOD had no intention of increasing spending on its installations. On February 25, 1999, Under Secretary of Defense (Comptroller) William J. Lynn III testified before the House Armed Services Committee that DOD’s goal was to “substantially improve these activities and get them to consume a *smaller portion of the defense budget*,”<sup>12</sup> a budget that had shrunk significantly over the previous decade. In his testimony, Lynn proposed a three-step plan to improve DOD installations:

- Seek additional base realignment and closure (BRAC) authority,
- Expand privatization, and
- Outlease underutilized property.

**Figure 1. Defense Spending as a Percentage of Real GDP, Fiscal Years 1989–2001**

DOD executed BRAC rounds in 1988, 1991, 1993, and 1998. However, after the post-Cold War drawdown, DOD estimated that it still had over 25 percent excess capacity across all services. Drawing down this excess via an additional round of BRAC was the backbone of DOD's installation improvement strategy. "Without such approval," Lynn testified, "scarce defense dollars will continue to be spent on excess infrastructure, rather than on the vital needs of America's armed forces."<sup>13</sup> Lynn went on to state:

The Department spends nearly \$2.5 billion a year on energy for its installations, consuming over 70 percent of all energy used by all federal facilities. This represents tremendous procurement leverage; yet excessive management attention and funding have been directed towards the operating and maintaining of DOD's large power infrastructure. Taking a lesson from industry, I believe DOD's energy requirements can be better met by relying on the private sector for our utility infrastructure and concentrating our management focus on energy use and cost.<sup>14</sup>

He also stated that the department's goal was "revitalizing or divesting our inadequate [family] housing by 2010 using both traditional military construction [MILCON] and privatiza-

tion authorities." Lynn completed his summary of DOD's installation improvement strategy by stating:

[T]he Department is considering how to better utilize fallow assets, both land and buildings.... [T]he Department's unused and underutilized property and excess capacity may have unrealized economic value and enhanced use leases could generate added value, either cash or in-kind consideration, to offset infrastructure funding shortfalls.

FIGURE 3 on page 143 depicts DOD's infrastructure investment strategy in general terms. Over time, DOD planned to draw down its installation expenditures. To accomplish this, it would expend significant upfront funds for the environmental cleanup and closure of excess installation capacity through two additional rounds of BRAC. Additionally, DOD planned to realize savings through the privatization of its utilities systems and family housing.

Bringing down expenses was key to the strategy, but equally important was DOD's belief that it could generate significant off-budget revenue if it were allowed to lease non-excess real property to the private sector. DOD already had the authority to outlease non-excess property for periods up to five years.

**Figure 2. Army Installation Maintenance Backlog, Fiscal Years 1998–2000**

| Fiscal Year | U.S. Army Restoration Backlog (\$ Billion) | Percent Increase from Previous Year |
|-------------|--|-------------------------------------|
| 1998        | \$20.5                                     | --                                  |
| 1999        | \$23.3                                     | 13.65%                              |
| 2000        | \$27.4                                     | 17.69%                              |

For many years, the Army had rented on-post property to private entities for cellular telephone towers, banks, restaurants, agriculture, and livestock grazing, but proceeds from these transactions were relatively small. Furthermore, they were deposited in the general fund of the U.S. Treasury and the proceeds never benefited the individual services directly, much less the installations. DOD was looking for more.

DOD had confidence in this strategy. Lynn testified that DOD's installation support strategy would produce a "balanced [military construction and installation support] program that will support new weapon systems being deployed..., accomplish new or changing missions..., address environmental compliance requirements, and...provide enhanced quality of life for service members."<sup>15</sup>

### Reinventing Government

As the crisis on the Army's installations was reaching a crescendo, President Bill Clinton launched his "reinventing government" initiative. Its impact was to have far-reaching effects on U.S. Army bases. In 1993, Clinton stated:

Cutting spending will be a priority. But so is making the system work better for the people who work in government and the people who pay the bills and are served by it. The truth is we can't achieve the savings we want simply by cutting funds. We must use the remaining funds in a much wiser way. We'll challenge the assumptions of every program, asking, "does it work; does it provide quality service; does it encourage innovation and reward hard work?" If the answer is no, or if there's a better way to do it, or if there's something that the federal government is doing it should simply stop doing, we'll try to make the changes needed.<sup>16</sup>

As part of this initiative, Vice President Al Gore led the "National Partnership for Reinventing Government," which sparked the introduction of reinvention initiatives across all departments of the federal government. One of the Clinton administration's primary targets for reinvention initiatives

was DOD. Even with only three percent of the GDP spent on defense, the administration believed DOD could make much more efficient use of its resources.

In 1999, as part of the push to redefine how the federal government conducted its business, DOD requested significant expansion of the services' authorities to lease non-excess real property. The new authorities would provide a win-win scenario for all who participated in these unique projects.

Specific benefits of these authorities that would be enjoyed by the Army included:

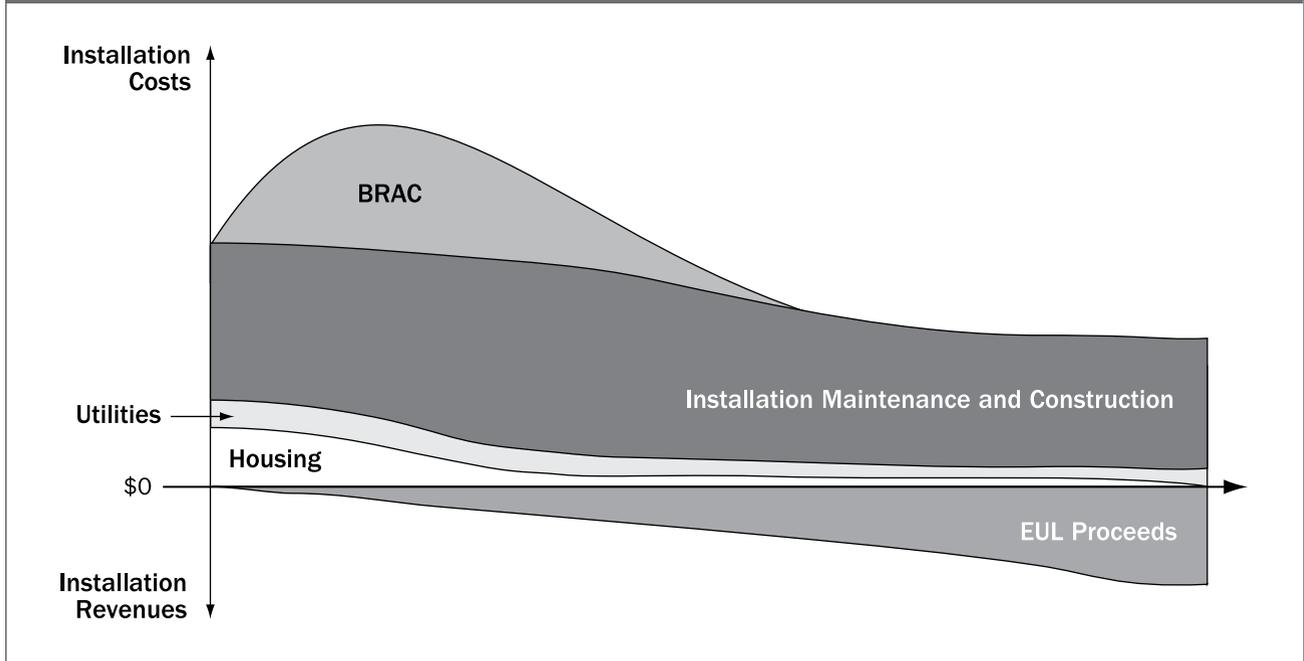
- Creating value from unused, non-excess property;
- Providing resources for needed modernization and development;
- Attracting tenants who complemented missions at the installation;
- Providing an in-kind funding source for needed and non-funded capital improvements;
- Offsetting declining operation and maintenance budgets;
- Enabling installations to avoid the costs of maintaining or razing old buildings;
- Freeing-up installation resources for other purposes; and
- Improving community relations.

The authorities would also provide private entities with a unique means to participate in previously unavailable development opportunities on Army installations. Other benefits to the private sector included:

- Opportunities to capture market rates of return on design, construction, maintenance, leasing/sales, and property management activities; and
- Access to new markets to meet the needs of private-use tenants, such as providing facilities for government contractors, upon whom the government is increasingly dependent.

Finally, the new authorities would benefit local communities that were adjacent to Army installations by:

Figure 3. General Graphic Depiction of DOD's Installation Investment Strategy (2001)



- Creating jobs in the local community;
- Providing for the development of convenient facilities and services for local, private, non-federal use;
- Bolstering community planning and development;
- Improving community relations with local military installations; and
- Generating tax or similar forms of government revenues.

Congress enacted these proposals in the Floyd D. Spence National Defense Authorization Act (FY2001 NDAA), which was signed into law January 28, 2001.<sup>17</sup> According to the conference report accompanying the FY2001 NDAA, the new provisions of the law would:

- Authorize the secretary concerned to lease facilities that are under the control of that department and that are not excess to the needs of that department;
- Authorize the secretary concerned to accept either payment in-kind or cash as compensation for the leases;
- Clarify that “in-kind” consideration may be applied at any military installation and that it may take the following forms:
  - Maintenance, protection, alteration, repair, improvement, or restoration of any property;
  - Construction of new facilities for the department;
  - Provision of facilities for use by the department;

- Base operating support services; and
- Other services related to the activity that will occur on the leased property, as the secretary considers appropriate;
- Authorize the secretary concerned to use cash proceeds from leases for maintenance, protection, alteration, repair, improvements, or restoration of property or facilities, construction or acquisition of new facilities, lease facilities, and facilities support; and
- Allow at least 50 percent of the cash payment received to be available for use at the military installation at which the property is located.<sup>18</sup>

DOD got what it wanted from Congress: the authority to enter into long-term leases for the development of, or repair to, nonexcess property or facilities. Furthermore, it had the authority to accept cash payments directly into accounts intended for the improvement of facilities from which the leases were made.

Passage of the FY2001 NDAA put the Army in a line of business to which it had little experience: long-term real estate development for commercial purposes. Over the past seven years, the Army has very aggressively and effectively implemented the authorities granted under Title 10, U.S. Code (U.S.C.) 2667. However, it must overcome substantive challenges if it is to continue to utilize this unique authority to

**Figure 4. Army EUL Projects in Various Phases of Development**

| Status                          | EUL Project Name                | State |
|---------------------------------|---------------------------------|-------|
| Phase 1. Project Identification | Natick EUL                      | MA    |
|                                 | Army Laundries EUL              | Many  |
|                                 | Wetlands Mitigation Banking EUL | NJ    |
| Phase 2. Concept Package        | Fort Irwin                      | CA    |
|                                 | Los Alamitos EUL                | CA    |
|                                 | Sierra Army Depot EUL           | CA    |
|                                 | Wright AAF, Ft. Stewart         | GA    |
|                                 | Fort Riley EUL                  | KS    |
|                                 | Fort Knox EUL                   | KY    |
|                                 | West Point EUL                  | NY    |
| Phase 3. Developer Acquisition  | Watervliet Arsenal EUL          | NY    |
| Phase 4. Lease Negotiations     | Redstone Arsenal EUL            | AL    |
|                                 | Camp Navajo EUL                 | AZ    |
|                                 | Snake Creek NG EUL              | FL    |
|                                 | Rock Island Arsenal EUL         | IL    |
|                                 | Fort Detrick GATEWAYS EUL       | MD    |
|                                 | Fort Meade EUL                  | MD    |
|                                 | Selfridge ANGB EUL              | MI    |
| Phase 5. Lease Administration   | Yuma HWTC EUL                   | AZ    |
|                                 | WRAMC Bldg 40 EUL               | DC    |
|                                 | APG-Maryland Blvd EUL           | MD    |
|                                 | Fort Detrick CUP EUL            | MD    |
|                                 | Fort Leonard Wood EUL           | MO    |
|                                 | Picatinny Arsenal EUL           | NJ    |
|                                 | Fort Bliss EUL                  | TX    |
|                                 | Fort Sam Houston EUL            | TX    |

**SOURCE:** U.S. Army, "EUL Project Status List," *Enhanced Use Leasing Handbook*, accessed at <http://eul.army.mil>.

the degree it has in the past. If these concerns are not resolved, Army installations may lose an investment stream that heretofore has produced over \$2.4 billion in off-budget capital.

### Army Implementation of EUL

The Army immediately seized the opportunity that the new EUL authorities presented and enjoyed success in its earliest project. This built momentum and a high degree of interest in the program across the Army. The Army then centralized execution of the program under one program office and

standardized its EUL business processes. It is now executing this authority to its great benefit.

### *Seizing the Opportunity: Initial Success*

As with all new projects, processes, or authorities, the first attempt to employ the new EUL authorities was closely watched. Army installations were watching to see if this might be a way to gain value from unused installation assets. Industry was watching to see if these projects would be worthwhile to pursue in the future. Local communities were watching to see

if this might be a new way to generate jobs and employ local industry. Congress was watching to see how the services would employ the new authorities. If the Army hoped to leverage these new authorities, its first EUL project at Fort Sam Houston, Texas, was going to have to be very successful.<sup>19</sup>

Fort Sam Houston had some significant financial albatrosses within its boundaries. Among them were three abandoned buildings constructed in the 1930s, including the historic Brooke Army Medical Center (BAMC). These buildings were obsolete for modern use and were contaminated with lead, asbestos, PCBs, and mercury. The installation's dilemma was that it did not have the funding needed to restore the buildings, yet it could not demolish them because they were considered "historic" facilities. Meanwhile, the buildings' security and carrying costs were draining Fort Sam Houston's operations and maintenance budget.

The installation staff, supported by the U.S. Army Corps of Engineers' Fort Worth District Real Estate Division, recognized that the new EUL authorities could provide a means to restore the buildings. They worked through an uncharted business and approvals process to award a lease to the Fort Sam Houston Redevelopment Partners, a partnership between Weston Solutions and Orion Partners, to turn this situation around. Under the lease, the Weston-Orion partnership agreed to redevelop nearly 500,000 square feet of office space, paying particular attention to historic rehabilitation and preservation and environmental restoration. They also agreed to pay the Army cash or in-kind consideration for a period of 50 years. The redevelopment occurred at no cost to the Army and Fort Sam Houston retained full ownership of the buildings while the structures were redeveloped and put into productive economic use. The Army will reacquire full use of the buildings at the end of the lease term.

Today, the redeveloped facilities are nearly 100 percent occupied. Tenants include the U.S. Army South, Installation Management Command, and the U.S. Army Medical Information Technology Center. Fort Sam Houston is projected to earn \$250 million in the form of cash and/or in-kind services over the 50-year lease term. In-kind projects at the installation have included landscaping, lighting, sidewalks, and building renovation projects.

Fort Sam Houston's groundbreaking project accomplished much, including:

- Freeing the installation from the cost of maintaining unusable facilities;
- Unburdening the installation from an expensive environmental remediation process; and
- Accomplishing all this by putting private financing to work.

The BAMC project shined a bright light on the broad potential of the EUL authorities. The Army's installation leadership used the BAMC project as a poster child for how 10 U.S.C. 2667 could be used to turn unused *assets* into useable *value*. BAMC's praises were heralded at installation and industry-related conferences, meetings, and seminars. Installations around the Army took notice. Industry's interest was piqued. The word was out.

### *Building Momentum*

As the word about EULs spread, directors of public works across the Army began looking at their own installations with an eye toward parlaying unused, non-excess property into value. However, they soon realized that individual installation staffs lacked the expertise to execute the new authorities under 10 U.S.C. 2667. They sought the assistance of their supporting Corps of Engineers district's real estate divisions to get them through the process. Even within the Corps of Engineers' tight-knit but geographically-dispersed real estate community, the expertise and experience to put together long-term, privately financed real estate development projects proved to be scarce. The Army, and the Corps, soon discovered that all roads related to EUL were leading to Baltimore.

In 1992, the Corps of Engineers' Baltimore District made a savvy hiring action when Mr. Bob Penn was brought on board as the chief of the appraisal branch in the real estate division. Penn had a long career in banking. Various motivations led him to government service, not the least of which was a "desire to make a positive difference in government."<sup>20</sup> Penn's unique background in private sector finance and real estate development, combined with a tireless drive and sterling communications skills, proved to be the perfect skill set to be the keystone of the Army's implementation of EUL authorities.

Initially, as the Army sorted out the business model that it would use to execute EUL on a long-term basis, Penn filled an informal advisory role on these projects. The Army's installation management community was soon seeking his expertise on EULs on a regular basis. It was becoming a full-time job.

At first, Army installations were pursuing EUL projects on a decentralized basis; there was little standardization to the

process with respect to lease requirements, legal review, environmental documentation, and approval. By 2004, the Headquarters of the Department of the Army realized that the Pentagon needed to get the program under control. Processes needed to be standardized and expertise needed to be leveraged on a formal and enduring basis. That year, Deputy Assistant Secretary of the Army (Installations and Housing) Joseph Whitaker formally designated the Baltimore district as the Army-wide “center of expertise” for EUL. He directed that the Baltimore district serve as the Army’s single point of contact for the development and execution of EUL projects.<sup>21</sup>

Whitaker and his staff worked very closely with the Baltimore district’s new EUL program office to develop and implement standardized practices and processes for EULs from inception to lease termination. These processes have been well-publicized throughout the Army, which then institutionalized these business practices by publishing an extensive *Enhanced Use Leasing Handbook*.

### **Execute!**

The Army’s highly effective implementation of the new authorities of 10 U.S.C. 2667 is principally the result of three factors:

- Incentives that encourage the pursuit of these projects at the installation level;
- A streamlined process that takes a project from concept to execution in light speed, compared to other appropriated projects; and
- Consideration of the concerns of the local community in the execution of these projects.

First, the Army has sustained the commitment that 100 percent of the proceeds from EUL projects will remain with the installation that is leasing the property.<sup>22</sup> According to 10 U.S.C. 2667, at least 50 percent of the cash or in-kind service from EUL projects must benefit the leasing installation, but the service is permitted to transfer the remaining 50 percent of the proceeds for the improvement of other installations. By allowing the leasing installation to keep 100 percent of the cash or in-kind services, the Army has created a huge incentive for installations to pursue these projects.

The Army also developed standardized business processes for reviewing, approving, executing, operating, and closing out EUL deals. The Army’s draft *Enhanced Use Leasing Handbook* defines a six-phase process (refer to **FIGURE 4** on page 144).<sup>23</sup>

### **Phase 1: Project Identification**

During this phase, the EUL team identifies a potential EUL project and proposes possible market opportunities and potential uses for the identified site. The team then meets with the local economic development authorities to explore how the project can meet the needs of the installation and the local community. During this phase, a “go/no go” decision is made on the project and the EUL team executes a memorandum of agreement to codify how the project will be executed. Phase 1 typically takes approximately four months to complete.

### **Phase 2: Concept Package**

In this analysis-intensive phase, the Army EUL team, supported by a real estate/financial consultant, performs the financial due diligence to ensure that the project is economically viable. They also conduct market research, certify that the property is not “excess,” and seek the approval of the deputy assistant secretary of the Army (installations and housing) (DASA(I&H)), in coordination with the Office of Management and Budget. Once approved, the Army notifies the House and Senate Armed Services Committees of its intent to enter into an EUL and awaits their approval. Phase 2 takes approximately six to eight months from start to finish.

### **Phase 3: Developer Acquisition**

During this phase, the Army selects its partner for the project through a competitive process among interested private sector developers and non-federal public or quasi-public entities. Interested developers submit their qualifications and an evaluation team evaluates the written submissions. Developers who are judged by the panel to be the most highly qualified are asked to give oral presentations on the details of their proposed project. The evaluation team then recommends the final selection to the DASA(I&H). Phase 3 lasts approximately five months.

### **Phase 4: Lease Negotiations**

During this phase, the EUL team and the developer finalize the lease document and develop the environmental documentation required by the National Environmental Protection Act.<sup>24</sup> The developer completes its economic due diligence and acquires the financing needed to develop the EUL site. Analysis completed during this phase ultimately determines the in-kind consideration that the Army will receive. Once all analyses are finalized, and following a thorough review process, the DASA(I&H) is the final approving authority on these documents. Phase 4 can vary in time, but typically takes approximately six to seven months to complete.

**Phase 5: Lease Administration**

This phase spans the life of the term of both the EUL master agreement to lease and the associated ground leases. The lease administration phase entails EUL project sustainment activities, in-kind consideration management, and in-kind consideration escrow account administration. Each of these functions involves planning, oversight, implementation, review, and accounting.

**Phase 6: Project Closeout**

During this phase, the ground lease expires and the developer relinquishes the site. The Army will determine if it wants ownership of the improvements or if the developer must restore the property to its original condition. The developer will mediate any environmental impacts to the project site, all accounts for the EUL project will be settled, and the Army will conduct a final audit of the project.

While the appropriated military construction planning cycle can take five to seven years to get from project concept identification to contract award, these processes can produce construction in less than two years. The reduced planning cycle is important in dealing with the private sector where financial assumptions can change quickly and unexpectedly.

It is incumbent upon the Army to have a streamlined process since private developers typically spend \$300,000–\$400,000 to prepare their proposals and an additional \$1 million to complete the analysis, planning, and design required for lease signing. Given these costs, a cumbersome process would only serve to discourage competition among interested developers, and create undue barriers to gaining backing from the financial sector.

To date, eight Army EUL projects are in the lease administration stage, with an additional 18 projects in various stages of development. They are located in over 20 different states, spread across all three components of the Army—Active, National Guard, and Army Reserve.

The Army's aggressive and effective implementation of EUL authorities is most directly measurable in the bottom line (i.e., how much cash or in-kind services installations have received). The results have been impressive. While statute requires the developer to pay at least fair market value in consideration for the lease,<sup>25</sup> the Army has received rent proceeds with a net present value in the range of 4.0 to 4.5 times the appraised value of the property being leased.<sup>26</sup>

Installations are receiving outstanding returns from their EUL projects. For example, the EUL project at Brooke Army

Medical Center is expected to earn over \$250 million over its 50-year life, far exceeding the fair market value of the property, while precluding an Army investment of millions in renovation, historical restoration, and environmental cleanup costs. Further examples of three of the Army's eight operating EUL projects may provide additional insight into the flexibility that the EUL authorities have provided the Army, and how EULs have been used to meet diverse requirements at different installations.

**Partnering with Industry for Mutual Use: Yuma Proving Grounds, Arizona**

The Army is DOD's lead agency for testing wheeled vehicles in hot weather environments. This is a particularly important mission in light of the dramatic spike in funding for vehicles which will operate in hot weather as part of the Global War on Terror. The Army tests the vast majority of these vehicles at Yuma Proving Grounds (YPG) in Arizona. Unfortunately, YPG's testing infrastructure consists of a single paved, 50-year old, deteriorated straightaway track. In this case, the shortfall in testing infrastructure was critical.

YPG proved to be an ideal installation where an EUL could be used as a means to meet this shortfall. The Army identified 2,400 acres of level land that could be used to develop a hot weather test track. While the land was "unutilized," *per se*, it was not considered "excess" because the land rested in a required buffer zone between the installation's ranges and the installation's boundary.

The Army sought to find a private sector partner to create a world-class "hot weather test complex" (HWTC) at YPG. Following a thorough qualifications evaluation process, the Army selected General Motors (GM) to develop a project that would be mutually beneficial. This process culminated on June 5, 2007, with the signing of an EUL. The term of the lease was 50 years with renewal options for two successive 25-year periods. GM was expected to complete construction of the HWTC by early 2009, with testing to begin in mid 2009. Construction of in-kind facilities for Army testing (which were funded by this project) are currently being negotiated, with construction expected to commence shortly.

Developers are required by statute to provide the Army with in-kind consideration (i.e., "rent") at least equal to the fair market value of the property. On the YPG EUL, GM met this requirement by agreeing to:

- Develop a multifaceted HWTC within the EUL site for their own use;

- Provide the Army with the use of GM's complex for testing military wheeled vehicles, in accordance with a joint-use protocol agreement;
- Include in the HWTC a dynamometer test pad, a paved straightaway, and a ride quality course, which would meet over 85 percent of the Army's requirements for testing its wheeled vehicle fleet (the net value of this use to the Army is estimated to be \$138 million over the term of the lease);
- Allow the Army to exchange rights of usage to test vehicles at other GM test facilities in Mesa, Arizona; Cupuan, Mexico; and Milford, Michigan Proving Grounds; and
- Deposit \$10.6 million in an interest-bearing, third-party managed escrow account for the design and construction of specific Army test courses.

As part of the agreement, the Army agreed to:

- Provide GM with 2,400 acres of land for the purpose of developing the HWTC;
- Allow GM free use of YPG's existing, primarily unpaved, vehicle test courses, and any courses constructed in the future;
- Sell utilities to GM at prevailing rates;
- Provide GM with water from YPG's existing water allocation; and
- Provide GM employees access to installation eateries and similar services.

The Army and GM will both benefit greatly from this deal. The co-location of leaders in the field of vehicle testing will offer opportunities for collaboration, cooperation, and information exchange. GM gained an ideal site to establish an automotive proving ground within the restricted confines of a major military installation, in the longest and hottest summer test climates in the United States, and immediately next to an extensive variety of off-road test courses and terrains. In turn, the Army gained test capabilities urgently needed to adequately test its vehicles in a high temperature, high speed venue. This deal is expected to provide the Army with substantial in-kind consideration over the term of the lease, without the expenditure of a single appropriated dollar.

### **Flexible Space for Mission Support: Picatinny Arsenal, New Jersey**

In 2006, the Army entered into a 50-year ground lease with a private developer at Picatinny Arsenal (PARC) in New Jersey to redevelop 100,000 square feet of obsolete facilities

and to develop 120 acres of land at Picatinny. At its conclusion, the PARC will include over a million square feet of new laboratory, administrative, education and training, and manufacturing space.

The developer on this project is InSitech Inc., a nonprofit corporation that will assist the PARC's Armaments Research, Development, and Engineering Center in developing technologies that have both military and commercial applications. The EUL was negotiated directly with InSitech in a unique, noncompetitive transaction. In collaboration with the installation and the Army EUL program team, InSitech has negotiated a series of agreements with a proposed sublessee, Forge Technology.

The project consists of 13 separate parcels. The master lease agreement requires the Army to transfer four parcels to InSitech. These "must take" parcels consist of 100,000 square feet of existing buildings and 15 to 20 acres of land for 150,000 square feet of new development. The remaining nine parcels, "options" under the master lease agreement, will transfer 100 acres to InSitech for 850,000 square feet of new development. Planners envision about 40 percent of the development to consist of laboratories, 50 percent engineering and office space, and 10 percent high-tech manufacturing and final assembly.<sup>27</sup>

All the tenants will be involved with the Picatinny mission. Within five years of the master lease signing, InSitech will deposit an estimated \$15.9 million into an escrow account to be used for installation improvement projects. In addition to these upfront payments, InSitech will pay rent based on the project's net cash flows. Across the life of the project, the PARC EUL will generate approximately \$500 million, which will be used by the installation to supplement appropriated funds for base operations, maintenance, and installation repairs. At the end of the 50-year lease term, InSitech will return the developed improvements to the Army in rentable condition, unless the Army opts to have the improvements demolished.

### **Generating Power and Profit: Fort Detrick, Maryland**

The National Interagency Biodefense Campus (NIBC), located at Fort Detrick, Maryland, is home to some of the highest-level biosafety containment laboratories in the world. The campus was constructed from the budgets of numerous federal agencies in the aftermath of 9/11. As home to some of the planet's most infectious strains of disease and viruses, safe operation of these facilities depends on high-quality,

extremely reliable energy, since a loss or unexpected variation in power, heat, or cooling could have devastating effects.

Providing power to the new campus was expected to be extremely expensive. Utilities running from the existing plant to the new campus were very long, and the existing plant lacked the capacity to provide utilities with the exacting specifications the laboratories required.

In 2004, NIBC identified the EUL authorities as an ideal means for constructing a new utility plant. Under these authorities, the Army leased 10 acres of non-excess land at Fort Detrick to Keenan Fort Detrick Energy, LLC, for the purpose of constructing a central utility plant (CUP), which would produce uninterrupted steam, chilled water, power, and emergency power to meet the energy requirements of NIBC.

The lease entitles Keenan to sell energy commodities generated at the CUP to customers on and off the Fort Detrick installation. Keenan, an experienced energy developer, partnered with Chevron Energy Solutions for the construction and operation of the utility plant.<sup>28</sup> Under this EUL, the Army will receive annual rent in the form of cash or in-kind consideration for the term of the lease. The lease term is for 36.5 years, with an option to extend the lease for an additional 13.5 years for a total lease term of 50 years.

The NIBC's operational requirements called for the CUP to begin energy production by mid 2007. Keenan met this fast-track schedule using a two-phased approach: the first phase provided for the immediate needs of select NIBC tenants, and the second phase provided energy production capacity to provide for both on- and off-post customers. In May 2008, Keenan completed the second phase of the CUP and began producing power for both on- and off-post consumption.

The EUL authorities provided the means for the Army to provide reliable power, heating, and cooling to the nation's most vulnerable biohazard laboratories in record time. From conception to beneficial use, the Fort Detrick CUP was up and running in three years. It may have taken the Army five to ten years—or more—to complete this \$100 million project through the normal MILCON appropriations process.

By seizing the opportunity that EULs can provide, building momentum off its initial success with EULs, and executing aggressively, the Army has maximized the potential of EUL authorities. However, in spite of all its success, the Army's EUL program is not without criticism or challenges.

## Challenges to Continued Use of EULs

The Army must address some challenges if it is to continue to utilize this unique authority as aggressively as it has in the past. The Army must work hard to overcome emerging congressional concerns with the program, sustain the support of local communities, and safeguard against abusing EUL authorities. Failing to do so may threaten the long-term viability of EULs and endanger a unique program that is expected to produce \$2.4 billion in off-budget proceeds over the next 50 years.

## Congressional Concerns

Congress has maintained a keen interest in the implementation of the EUL authorities since passing the FY2001 NDAA. The House and Senate Armed Services Committees have overseen the implementation of the authority through frequent briefings, visits to the projects, and hearings. Additionally, the Government Accountability Office has investigated and reported on various aspects of the services' implementation of 10 U.S.C. 2667 at the committees' requests. Through its oversight, some in Congress have developed concerns with how the services are implementing this authority. These concerns are addressed as follows.

## Lease Terms

As noted by 10 U.S.C. 2667, lease terms "may not be for more than five years, unless the secretary concerned determines that a lease for a longer period will promote the national defense or be in the public interest." A five-year lease would attract little interest from the private sector due to the limited potential to turn a capital investment into a profit in such a short timeframe. From the Army's perspective, longer leases represent greater fair market value and a greater potential to generate higher in-kind consideration for the property.

Consequently, the Army typically exercises the authority to extend lease periods on Army EUL projects to 50 years or longer. Some projects offer options that extend lease terms to as long as 100 years. Congress is concerned that these long-term leases commit the installation to unrealistically long use of the property and will unnecessarily restrict the use of the property in years to come. For example, rhetorically speaking, how would the U.S. Army of 1909 have predicted land requirements on an installation today?

The oversight committees also raise questions as to whether property that is leased for 50 or 100 years is truly "non-excess," as the law requires. If the installation does not need the property for mission-related purposes for the next 100 years,

is the property really needed at all? Rather, should it be reported as “excess” and disposed of under existing statutes? As such, certain individuals have indicated their intention to pursue future legislation that would restrict EUL lease terms to a maximum of 50 years.<sup>29</sup>

### ***The Proper Role of Government***

Some professional staffers have philosophical concerns that EUL authorities allow the services to improperly compete against private entities in the commercial real estate development industry; they assert that this is not the federal government’s role, and they hold that if the Army requires an HWTC, an office park, increased operations and maintenance funds, or office space, it should make the capital investment through its normal budgeting processes. They do not believe that the Army should have the authority to gain value from unused, federally-owned assets. Additionally, they hold that it is improper for government officials to choose between potential commercial uses of federally-owned property and facilities.

### ***Appropriate Congressional Oversight***

Some in Congress are concerned that EUL authorities infringe on Congress’ oversight responsibilities. This perception has been exacerbated by the fact that, on some projects, the Army “leased back” portions of the improved property from the developer for its own mission-related purposes. Some in Congress believe that these “leaseback” arrangements circumvent Congress’ right to provide oversight of the military construction process. They also suggest that Congress’ current oversight of the EUL process is insufficient to ensure that the services are not overstepping the intent of 10 U.S.C. 2667.

The Army is not required to seek specific authorization to undertake individual EUL projects; 10 U.S.C. 2667 and 10 U.S.C. 2662 only require the Army to notify Congress of any planned lease if the annual fair market rent exceeds \$750,000 per year, in which case the Army may not proceed with finalizing the lease for 30 days following the notification. This allows the committees of jurisdiction to review the project and ascertain the support of congressional delegations that are affected by the EUL development. Should Congress express concerns or questions about a particular EUL notification, it is customary to delay proceeding on the project until those concerns or questions have been answered.

Some feel that the congressional oversight of these projects should be stronger than the current “notice-and-wait” procedure. Congress acted on these concerns in the Fiscal

Year 2009 National Defense Authorization Act (FY2009 NDAA) by removing the authority to leaseback EUL property valued at more than \$750,000 per year. The FY2009 NDAA also enacted additional reporting requirements in order to make the EUL plans more transparent.

Recognizing that some in Congress have concerns with the program, it is imperative that the Army continue to execute the EUL program in a completely transparent manner in all dealings with Congress. This should be accomplished by:

- Maintaining regular contact with, and proactively providing information to, committee professional staff members on EUL projects;
- Involving local congressional delegations early in the project development process, and sustaining contact throughout the project development process;
- Leveraging the support of the delegations whose districts are home to the Army’s successfully operating EUL projects;
- Leveraging the support of the real estate development community;
- Hosting congressional delegations and staff visits to EUL projects during travel; and
- Making financial information available to all stakeholders, including Congress, on how EUL project proceeds are being used.

### **Maintaining the Support of Local Communities**

“If a project doesn’t fit off post, it won’t fit on post.”<sup>30</sup> This succinct statement perfectly summarizes the Army’s mantra when it comes to the involvement and support of local communities with respect to EUL projects. It would be imprudent to pursue an EUL project at an installation where the local civilian community did not support it. A potentially problematic aspect of the relationship between the Army and the local community relates to the allocation of costs associated with these projects.

Federal land is exempt from local or state property taxes, unless the federal government waives this immunity.<sup>31</sup> Immunity from local and state taxation is explicitly waived by 10 U.S.C. 2667, which states:

[T]he interest of a lessee of property leased under this section may be taxed by state or local governments. A lease under this section shall provide that, if and to the extent that the leased property is later made taxable by state or local governments under an act of Congress, the lease shall be renegotiated.

Based on this statutory language, state and local officials have not hesitated to levy taxes on the privately constructed facilities.

Equitable distribution of the community-impact costs associated with EUL projects can also be difficult to determine since the local community does not typically provide the EUL facilities with all of the services that are customarily funded by property taxes. For example, the Army usually provides utilities and emergency services to the developer's EUL facilities on a cost-reimbursable basis. The Army has the legal jurisdiction to respond to fires and emergencies on its land, even if such emergency services are outsourced. Also, Army-owned utilities infrastructure already exists on the premises of EUL projects; the cost of providing utilities infrastructure to one small portion of a military installation would be prohibitive.

In addition, EUL projects impact local communities beyond the provisioning of utilities and emergency services. For example, EUL projects may increase traffic on the local road networks, causing increased transportation and maintenance costs. Most local communities believe that either the developer or the Army should pay for such impacts through either taxation or user fees.

In response to whether taxes or impact fees should be assessed against private facilities built on federal property, the State of Maryland Attorney General recently opined:

With respect to impact fees, it is first necessary to determine whether the particular impact fee is properly categorized as a tax or a regulatory fee. If it is a tax, the question then is whether the federal government has waived immunity for that type of tax. If it is a regulatory fee, the question is whether the regulatory regime involving the fee existed and remained applicable as federal law at the time that the state ceded jurisdiction over the property to the federal government; or, if the state regulatory regime was a later enactment, whether Congress has expressly subjected the enclave to that type of state regulation. For example, land at Aberdeen Proving Ground was recently leased to a private developer pursuant to 10 U.S.C. 2667, which authorizes enhanced use leases (EULs) of land on military bases. That statute specifically waives the federal immunity from local property taxation for the private interests in real property created under an EUL. Accordingly, those private interests are subject to state and local taxation, unless Maryland law otherwise exempts the property.<sup>32</sup>

Based on the Maryland attorney general's opinion, the state assembly has passed legislation that will mandate taxation for

future EUL projects in the state of Maryland. However, this legislation is not at all objectionable to the Army. The Army's position on taxing EUL projects is simply that it does not want its EUL partners to pay twice, nor does it want to alienate the communities that are such a vital component of a successful EUL deal. If the Army is providing utilities, emergency, and other services that are typically provided by the municipality, then the EUL partners should not have property taxes levied against them. On the other hand, if local communities provide these services, then an equitable tax assessment is appropriate. Likewise, if an EUL project has legitimate off-post impacts, then an equitable assessment against the project developer is appropriate.<sup>33</sup>

One key to the Army's success in the EUL arena has been its broad and consistent outreach to local communities. If the local community is opposed to an EUL project, the project will have little chance of being successful. The Army must continue to deal with community representatives as co-equal members of the project team if it hopes to successfully address issues of vital interest to the community. Of all issues that the project team will address, taxation is the most contentious.

Strong local community support for EUL is a prerequisite for initiating an EUL project. This research found no indication that the Army is pursuing projects in locales where community support is not solid, nor were any indications found that community support for these projects erodes over time. As such, the Army should:

- Continue its current aggressive outreach to local communities throughout EUL projects' life cycles;
- Maintain its policy that EUL projects should pay their fair share of the costs associated with supporting new development, either through taxation or impact fees;
- Work closely with state and local taxation authorities to accurately assess the long-term impacts of the projects in order to maintain long-term support;
- Publicize the goodwill that EUL projects have created between local communities and Army installations; and
- Leverage the support of the local civilian aides to the Secretary of the Army on issues relating to community support.

### Appropriate Application of EUL Authorities

When Congress expanded DOD's EUL authorities in 2001, the services were provided with a great deal of flexibility in terms of how the projects were to be executed, what the proceeds could be used for, and few restrictions on what type of development the services could pursue. This allowed garrison commanders a great

deal of latitude in identifying the types of development that would best serve the particular installation's mission and needs.

As the EUL program has matured, many good ideas have emerged, including:

- Enterprisewide application of EUL proceeds;
- Narrowing the focus of EUL projects; and
- Applications of the EUL authorities, which, in the long-term, will only serve to restrict the latitude that 10 U.S.C. 2667 provides.

### ***Enterprisewide Application vs. Local Incentives***

The new EUL authorities created a tremendous incentive for individual installation commanders to pursue and execute these projects, since, by law, individual installations are the beneficiaries of at least 50 percent of the in-kind cash or service.<sup>34</sup> However, an individual installation's plans for in-kind cash and services may not always reflect the Army's enterprisewide needs.

In the case of a current EUL project that is underway at Fort Meade, Maryland, for example, the partner on the project is developing two 18-hole golf courses as partial in-kind consideration for the lease of approximately 173 acres to develop an office park. Army-wide, there may be no shortage of golf courses. There is, however, a drastic need to quickly construct barracks, headquarters, motor pools, and training ranges to facilitate unit moves associated with BRAC and the Global Defense Posture Review.

Some argue that the Army would be better served by using 50 percent of the in-kind consideration from EUL projects to complete higher priority projects across the Army, rather than allowing the leasing installation to keep 100 percent of the proceeds for its own purposes. However, this enterprisewide approach to the proceeds realized through EUL projects would be detrimental to the installation-level incentive to seek the projects in the first place.

Generally, EUL ideas are generated from the installation level. The leasing installation's staff has the largest and most resources, as well as the most time-intensive roles, in an EUL project. Their efforts are not required by law or by regulation; they are willing to expend the effort and resources to seek and pursue EUL opportunities because they get to keep the proceeds. Should the Army move to an enterprisewide application of the EUL authorities, installations—who would see their individual benefits cut in half—would have far less incentive to pursue EUL opportunities.

### ***“Getting off the Grid”***

As part of the strategy to reduce long-term spending on installations, the Army aggressively pursued the privatization of its on-post utilities. As of September 30, 2006, the Army had privatized 118 utility systems in the United States, and another 75 were under evaluation.<sup>35</sup> In so doing, the Army became dependent upon the civilian sector for much of its electrical power production and distribution. This concern has driven many to question whether the EUL authorities might be the best vehicle for reducing the Army's reliance on private power production.

Consider the possibility of leasing non-excess property to private entities that could produce alternative energy at wind farms or using vast arrays of solar panels. Proponents of this initiative believe that the Army could also use EUL authorities to produce conventional power production plants that are obligated to provide power to the Army on a priority basis.

On the surface, EUL authorities seem like an excellent means to provide the Army with more reliable utilities. However, this initiative deserves careful consideration before it is implemented wholesale across the Army. While EUL authorities may enable some garrisons to acquire more reliable power, EULs should not be considered a universal remedy in this regard. The following are all questions that need to be carefully considered before making the EUL authority the Army's panacea to get off the civilian grid:

- Is there a requirement to pursue more secure power across the entire Army?
- Is there a market to pursue such a far-reaching initiative?
- Will local communities support such an initiative?
- What about the local utility who has invested heavily in updating decayed infrastructure in the years since taking over the local installation's systems?
- What incentives will drive installations to invest the time and effort required to bring an EUL project to fruition?

### ***Avoiding Abuse***

Some might call it “bureaucratic greed.” Whenever a new authority is granted, eventually someone will be tempted to stretch the authority to accomplish more than Congress intended. The EUL authority is no exception, and the Army must be on guard for such abuses.

An example of bureaucratic greed includes considerations by some to invoke EUL authorities to lease unused air pollution credits to private entities for cash or in-kind services. Also, some

developers have inquired as to the possibility of using EUL authorities to lease non-excess wetlands on military installations to utilize these wetlands as mitigation banks to provide compensation for impacts to aquatic resources by activities that are permitted by a state or federal regulatory agency.

These initiatives are highly questionable on a number of levels and are clearly well beyond the EUL authorities' legislative intent. If not checked, initiatives such as these will force Congress to limit the EUL authorities from which the Army has benefitted so richly. All services, not just the Army, must be on guard against such abuses or risk the curtailment or loss of these valuable authorities.

## Conclusion

Seven years have passed since *USA Today* reporter Andrea Stone brought the decrepit condition of Chief Warrant Officer Butch Zirpolo's maintenance hangar to the attention of the American public. Had Chief Zirpolo's unit been fortunate enough to have been based on an installation that had entered into an EUL agreement, the garrison commander would have had off-budget funds at his disposal that could have been used to install some insulation, repair leaky roofs, replace missing windows, provide sufficient lighting, and install reliable hangar doors. Thanks to the Army's aggressive and effective implementation of the EUL authorities, there is an increasing probability that hardworking soldiers like Chief Zirpolo will live and work in conditions that are commensurate with the quality of their service to the nation. *JCM*

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