

The Folly of Consequence-Free Budget Scoring



Folly

- Main Entry: **fol·ly**
- Pronunciation: 'fä-IE
- Function: *noun*
- Inflected Form(s): *plural follies*
- Etymology: Middle English *folie*, from Anglo-French, from *fol* fool

- 1 : lack of good sense or normal prudence and foresight

- 2 a : criminally or tragically foolish actions or conduct b *obsolete* : EVIL, WICKEDNESS; *especially* : lewd behavior

- 3 : a foolish act or idea

- 4 : an excessively costly or unprofitable undertaking...

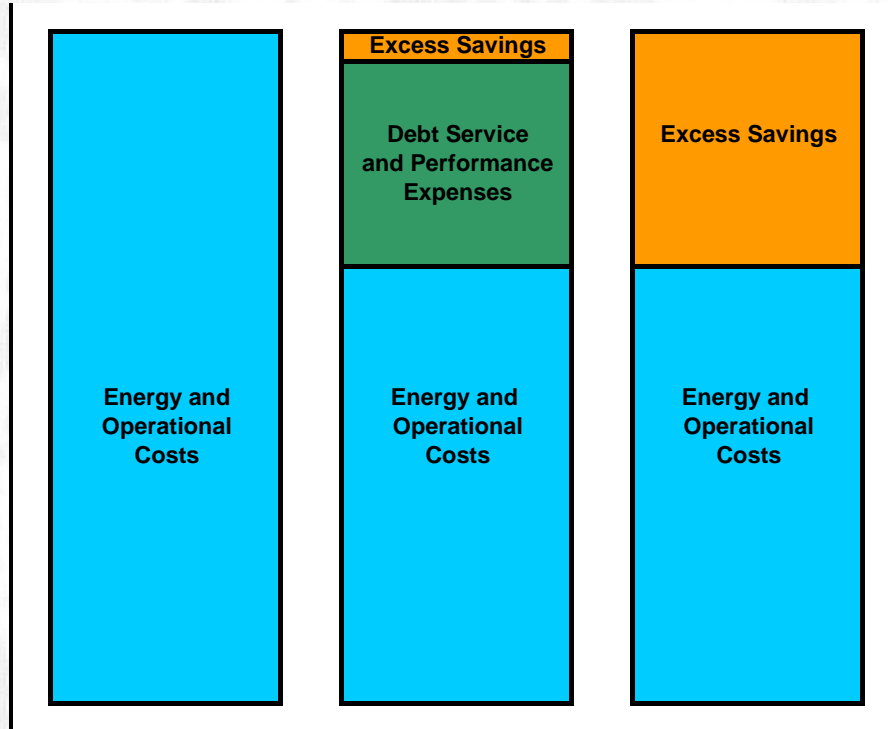
- From Merriam-Webster Online Dictionary www.m-w.com/dictionary/folly

“The Big Idea”

Before

During

After



- A contractor will make capital upgrades and savings are produced;
- Those savings are used to pay debt service on the capital portion, along with performance expenses for the term of the contract;
- During the term of the contract, a small portion of produced savings are retained by the Agency (optional); and,
- Once the debt service is satisfied and the contract term expires, the Agency retains 100% of the savings produced.

What's in it for me?

For Government agencies:

Paid-over-time solutions bridge the gap between what Federal agencies need and what they can acquire from current appropriations. If done properly, these solutions leverage future year appropriations without violating the Anti-Deficiency Act and shift contract risks to the private sector.

For Prime Contractors:

Paid-over-time solutions create sales opportunities that would otherwise not exist. If done properly, third party financing can accelerate revenue recognition under applicable accounting rules (FAS 140 / SOP 97-2).

For Taxpayers & Warfighters:

Maximizes “bang for the buck.”



The U.S. Federal Government is the largest purchaser of goods and services in the world. While a large portion of the Federal Government's annual procurement is acquired outright from current appropriations, the remainder is purchased over time via service contracts, performance contracts, operating and capital leases and installment sales agreements.

Illustrative Example

Paid Over Time contracts can convert future year operating dollars into today's capital upgrade.

Example --

	2005	2006	2007	2008	2009
Current O&M Budget:	\$5.0M	\$5.0M	\$5.0M	\$5.0M	\$5.0M
Payments Over Time: \$4.5M	\$4.5M	\$4.5M	\$4.5M	\$4.5M	
PV = System Cost:	\$22.0M	←—————			
Agency Savings:	\$0.5M	\$0.5M	\$0.5M	\$0.5M	\$0.5M

Vendor makes a \$22.0M sale despite the agency having only \$5.0M in annual appropriations

Agency receives the benefit of a \$22.0M system acquisition with no upfront investment.



Historical Uses of Paid-Over-Time Federal Contracts

**Only Certain Asset Classes are Procured This
Way:**

- Information Technology
- Telecommunications
- Energy Infrastructure
- Real Property



Hannon Armstrong financed the DOD's Telecommunications Modernization Program, principally located in the Pentagon.. "TEMPO" was one of the largest telecommunications transactions ever completed for the Federal Government and involved funding takedowns over a five-year period.

Types of Contracts:

- Software Licenses
- Service Contracts
- Energy Savings Performance Contracts (ESPCs)
- Utility Energy Service Contracts (UESCs)
- Enhanced Use Leases (EULs)
- Public Private Ventures (PPVs)
- Inter-Agency Agreements (IAAs)

The Second “Big Idea”

The traditional model is that the government buys goods and services...



... and produces services to society.

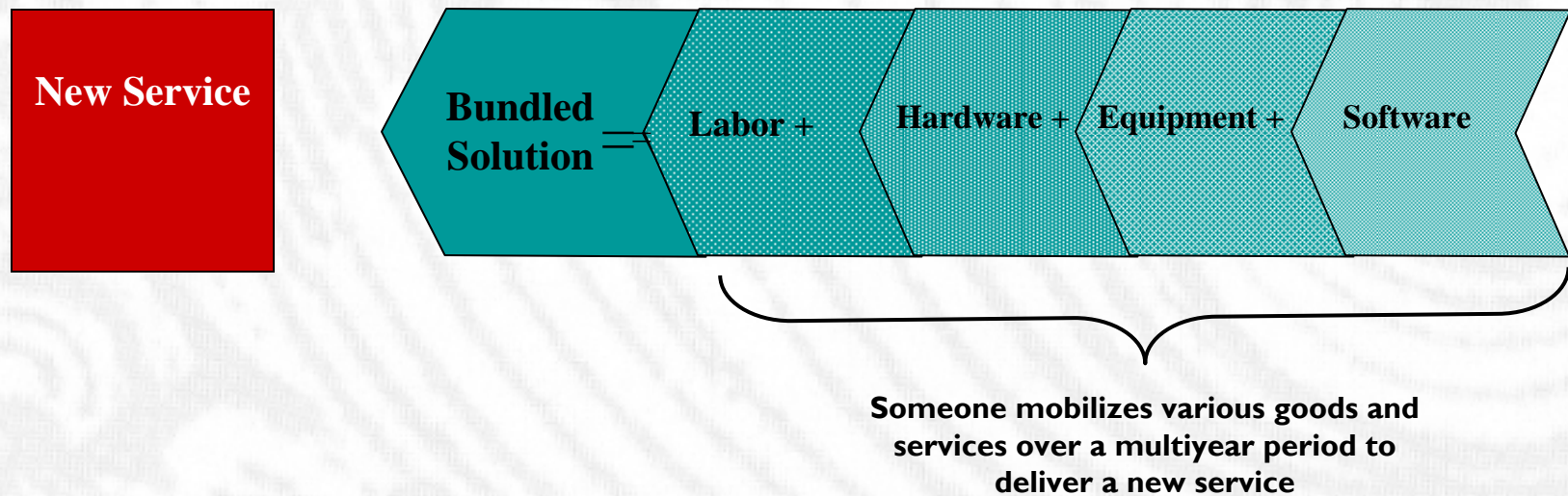
The Second “Big Idea”

The modern trend is that the government buys services...



... and produces services to society.

It is all a question of who is more efficient at bundling goods and services: The Federal Government or the Private Sector?



Example: Federal Service contracts where performance requires an upfront investment in Labor, Hardware, Software and/or Equipment.

The Future: Combat Assets

Paid over Time Contracts have traditionally been used to harness efficiency advances in technology for buildings and related administrative systems.

The same principles apply in combat system applications, plus two additional benefits:

Greater Combat Range



Less Logistical “Tail”



Combat System Applications

The Major Opportunities



DOD Overview



Defense Science Board

Defense Science Board Task Force on Improving Fuel Efficiency of Weapons Platforms' Report on *More Capable Warfighting through Reduced Fuel Burn*, dated January 2001, lists 16 economically-justified upgrades, including:

Army Abrams Tank APU

Army Abrams Tank Reengining

Army OH-58D, AH-64, UH-60, CH47D helicopters (IHPTET).

Navy "Hotel Load" Gas Turbine Upgrades

Navy Diesel Powerplant Improvements (Fuel Injection)

Air Force B-52 Reengining

Air Force Advanced Computer Flight Plan Program

Air Force Aircraft Communications Addressing and Reporting System

Air Force Worldwide Aeronautical Route Planner

Air Force Information for Global Reach

B-52 Reengining

Two Studies

- Defense Science Board Task Force on B-52H Re-Engining, June 2004



- Air Force / Boeing Feasibility Study, September 2003



B-52 Reengining



Defense Science Board Task Force on B-52H Re-Engining Recommends:

- “B-52H re-engining represents low technical risk.”
- “B-52H re-engining provides greater operational flexibility and range, reduces fuel burn and tanker demand, and produces significant depot and field maintenance cost and manpower savings.”
- “B-52H re-engining is an excellent pilot program for expanding the use of Energy Savings Performance Contracts beyond fixed facilities and into mobile systems.”**

Other Air Force Upgrades

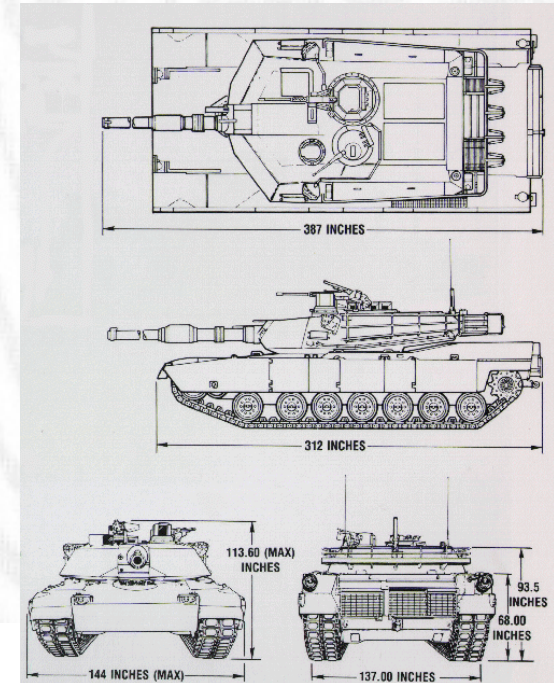
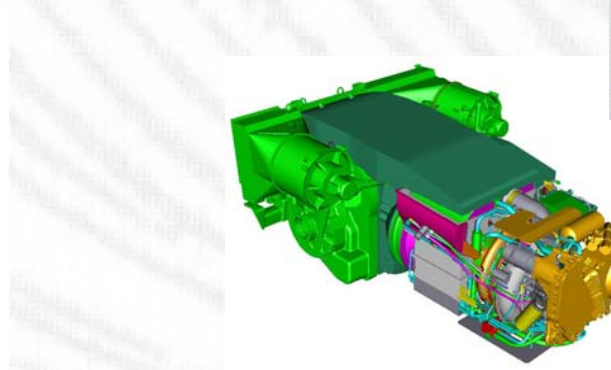
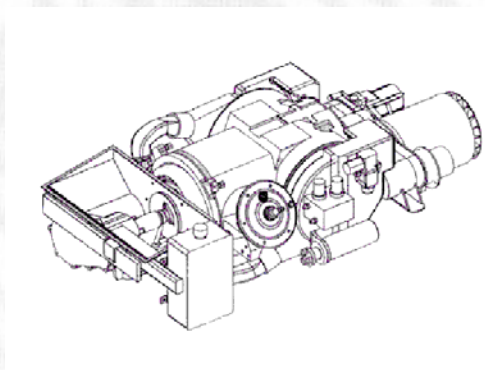


In addition to the Defense Science Board recommendations, the C-5 Galaxy strategic transport aircraft is a potential candidate:

- The US Air Force has already initiated a comprehensive upgrade program.
- The first phase of the upgrade is the Avionics Modernization Program (AMP).
- The second phase, the C-5 Reliability Enhancement and Re-engining Program (RERP) is to upgrade the aircraft's engines, pylons and improve reliability.

Abrams Main Battle Tank

- Abrams tank main engine upgrade or remanufactured replacement for the current (30-year-old) AGT 1500 engine.
- Abrams tank auxiliary power unit (APU) to provide power to electrical, hydraulic and climate control systems while in “silent watch” defensive posture.



Navy “Hotel Load” Gas Turbine Generators

Navy ships’ “hotel loads” are actually very similar to lighting, heating and cooling functions covered in traditional “facility” ESPCs. Generators and virtually any energy consuming equipment onboard ships could be upgraded under a Mobile ESPC.



The Three Choices

A. *Outright Purchase*

\$4 Billion

B. *Pay Over Time*

\$8 Billion

C. *Do Nothing*

\$15 Billion

Case Study



How the Federal Government Upgraded Capability and Saved \$140 Million Using Alternative Financing

The Problem:

U.S. Government collects time-critical information from numerous polar-orbit satellites at a unique and remote location above the Arctic Circle.

Once collected at the remote location, the information had to be re-transmitted to the U.S. through other geo-synchronous satellites, which was expensive, slow and unreliable.

NASA, NOAA and USAF agreed that the solution was the installation of a 1,300 kilometer fiber-optic cable connecting the remote Arctic Ocean island with the European mainland.

However, this solution had a barrier: there were no capital appropriations to implement the \$40 million project – only \$10 million in annual operating funds to purchase satellite time.



Case Study Economics

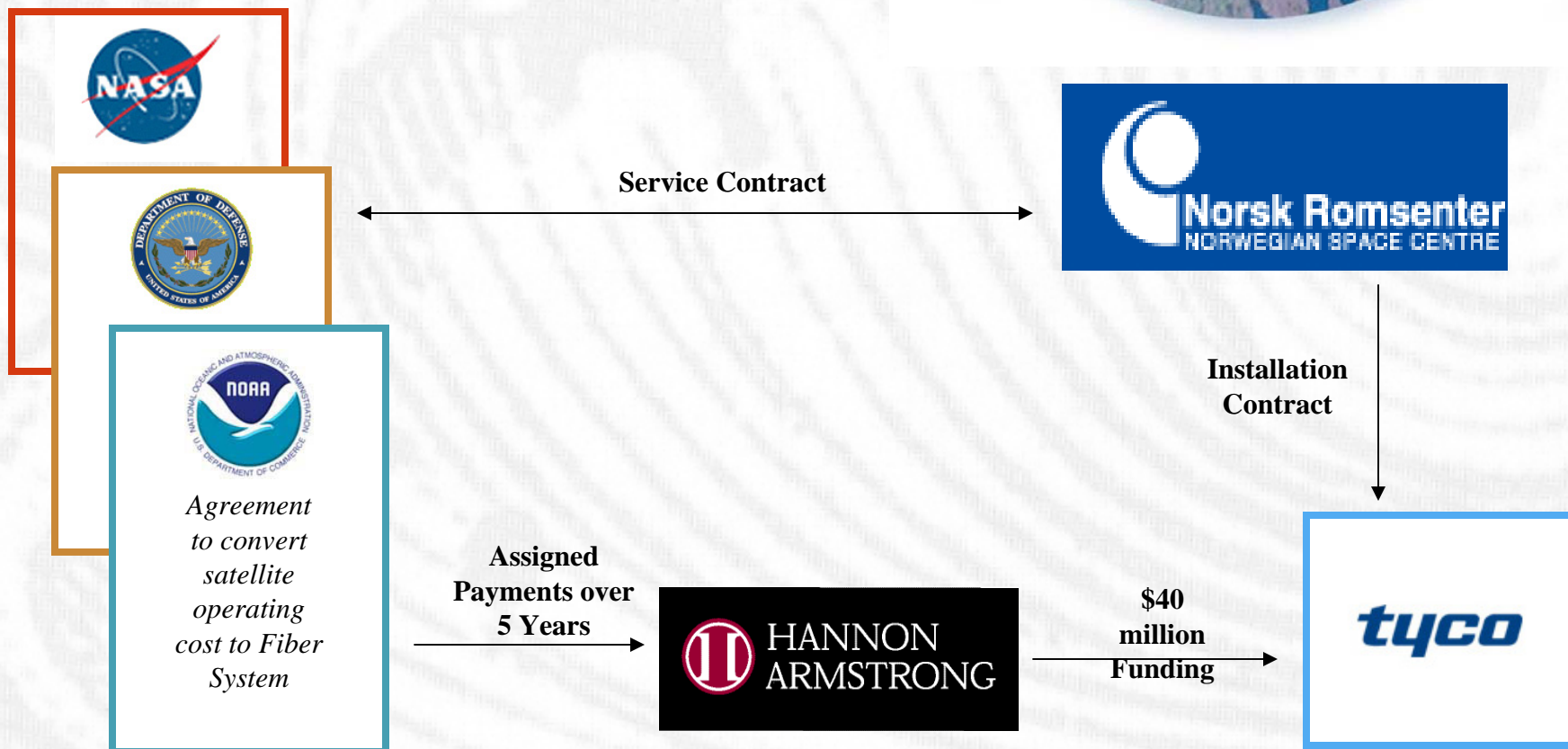
The Solution:

Convert budgeted operating dollars into a stream of payments that could support the \$40 million upfront capital investment required to implement the service contract.

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>....</u>	<u>2025</u>
Budgeted Operating Payments:	\$10m	\$10m	\$10m	\$10m
Total Projected Payments:	\$200m	←			
System Cost (paid over 5 years):	\$40m				
Net Savings (years 6 thru 25):	Approx \$140m				



Case Study Structure





Case Study Results

Federal Government realizes substantial budget savings while receiving the benefits of a vastly improved information system.

Specifically, the fiber-optic system is:

Faster -- 12 times faster

Better -- No bi-annual sun outages and other atmospheric effects

Cheaper -- Saves \$140 Million for the U.S. Taxpayer



HANNON
ARMSTRONG

America's Leader in Federal Contract Finance

www.hannonarmstrong.com