Armament Retooling and Manufacturing Support (ARMS)

Growing the Program

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Agenda

- Problem Statement
- BLUF
- Background
- Options
- Considerations / Way Ahead

Bottom Line Up Front (BLUF)

- Develop strategies for success
  - Address risk mitigation / incentive recovery
- Establish an ICAP Sub-group for ARMS

Problem Assessment

- Facility contractors aren't submitting "Projects" that require "Investment Recovery"
- Army is missing out on other financial opportunities (through absorbed overhead) by the facility contractor not selling additional products and/or services (water, IWTF, security,…)
- Challenge:
  - Protect Army Investments
  - AAA Audit (1997) & IOC CS support "Incentive Recovery" through additional weight to project selection criteria
  - Create environment of "Shared Risk"
  - Reward through incentives those that "Share Risk"
  - "Investment Recovery" disincentivizes our ability to support "Small Business"
  - ASPI doesn't require any form of "investment recovery"

Background

- Change in interpretation of 1997 Audit Report (about the 2005 timeframe)
  - Required facility contractor guarantee of all ARMS investments
  - Unintended affect placed all risk of operations on facility contractor
  - Other decisions eliminated financial rewards and potential benefits
  - Corporate decisions made to not take unnecessary risk (to the corporation) without possibility of reward
  - ARMS proposals substantially reduced / in some cases ceased to be submitted
- Facility contractors must be allowed to earn a fair profit for risk taken
- “Growing the ARMS Program” must be consensual to all parties

Success is not to reduce the contractor’s share of revenue…but to increase the size of the revenue pools benefiting both the Army and the facility contractors

Option 1

- Concept:
  - Retain some guarantee provisions/requirements
  - Exercise “Claw Back” provisions
    - required by most states
    - Goals not met…funds must be returned to facility contractor
  - Specific costs wouldn’t be applicable to any guarantee
  - No profit on ARMS Projects
- Proposed business case:

Total Army Investment (ARMS Project)	$1,000*
Less percentage applied to Overhead	<$350>
Value of Improvements/Actual Army Investment	$ 650
Less value of work required for Army mission **	<$250>
Less increased property value **	<$100>
Value of Guarantee	$ 300

*** All amounts are in the thousands**

**** Army receives value with improved building(s) (OHSA compliant, ADA Accessible,…) and are generating revenue (and/or in-kind services) that reduce the (Army’s) Total Cost of Ownership**

Option 2

- Concept:
  - Evaluation accomplished (see option 1) to determine value of guarantee
  - Facility contractor would obtain “Surety Bond” or “Insurance Policy”
  - Army must approve final value / reduces proportionally with recovery of investment
  - Tenant responsible for payment (Surety Bond, Insurance Policy, Cash Deposit or Self-Insured
  - Beneficiary is the facility contractor
  - Should facility contractor provide guarantee (holder of the bond)
    - Allowable cost against ARMS
      - Generally 3 to 4 percent of value
      - Paid out of ARMS Revenues or paid through a transaction fee against tenant (invisible to them)

Option 3

- Concept:
  - Possibly least costly to the Army…eliminate the cost of a bond / insurance
- Facility contractor establish / develop a “Line-of-Credit”
  - Only to the value of existing guaranteed tenant use agreements
  - Adjusted annually
- With failures…both Army and facility contractor lose due to loss of revenue in the pool for projects
- Prior to exercising “Line-of-Credit”...ARMS Team would be notified and provide approve
- Should tenant go under…the financial institution pays the “Investment Recovery”
- Financial Institution is paid (principle plus Interest) out of:
  - ARMS revenue (plant specific)
  - Consider use of transaction fee (one to two percent) to the negotiated cost of all new tenants

Option 4

- Concept:
  - Army wouldn’t except the facility contractor to be responsible for any guarantee if successfully locating a replacement tenant within specified period of time
  - Administratively challenging (rate determination, plant competitions, a new tenant purchasing more or less services,…)

Option 5

- Concept:
  - Guarantee has not been applied as envisioned
  - Eliminate the guarantee except in special cases

Preliminary Considerations

- There must be “Shared Risk”
- Need to further develop incentives for facility contractors that engage the ARMS Program and do share some risk
- Need to be sensitive to “Small Business” and look at establishing ceiling (nothing more than $$$) and floors (nothing less than $$$) as appropriate

Recommendation (Pre-decisional)

- Consolidate the "Goodness" of options 1 & 2 into a single strategy
  - Option 3 is thinking outside the box but isn't ready for the "Prime Time Players"!
  - Option 4 likely creates too many administrative challenges
  - Option 5 eliminates "Shared Risk"
- Maintain "Standardize / Incentivize" Concept
- Guarantee only applies to large ARMS investments
  - No investment recovery for anything less than $250K to $500K
    - Based on value to the Army
    - Similar to current state incentives
  - Army investment value of greater than $250K to $500K
    - Surety bond / insurance policy
    - Must determine finance protocol
      - Facility contractor / tenant / ARMS pays???
      - Authorized ARMS expense, collection through revenue pool or assessed to tenant
- Republish Project Selection Criteria
  - Add 10 points to any proposal that has "Investment Recovery"
- Enhance "Revenue Distribution Model / Rent Collected":
  - Status Quo for existing tenants
  - 90 (pool) / 10 (facility contractor) split for new tenants*
  - 85 (pool) / 15 (facility contractor) once new tenant investment is recovered
  - 80 (pool) / 20 (facility contractor) if new tenant stays for 5-years or more

* If tenant fails in first 12-months…no fee

Feedback for the Marketeers

- "The Army owns the property-the contractor has simply been a property manager thru the process. The incentive should be that the contractor will receive revenue by having tenants on-site. In the commercial world, if the property manager does not have someone in a building they do not gain revenue for the owner or themselves".
- "Applaud your efforts to bring this topic to the fore-front"
- "There is no one option that will work across the board for each facility because we all have different agreements in place for how the ARMS Program is structured at each site"
- "Need to have a property management incentive as well as a marketing incentive".
- "Would not agree for us (as the contractor) to pay for the bond, so that leaves the ARMS program or gov't paying for the bond"

Industry Prospective / ARMS

- Joel Gregory's Briefing (Fall 2006):
  - What is the objective?
  - How should risk and reward be apportioned?
  - What is an acceptable ARMS Tenant?
  - How can the process be streamlined?
  - Can the program survive at current funding levels?
  - Risk vs. Reward
    - Army enjoys benefits
    - Contractor assumes risks
    - Operating contractor loan guarantees (incentives not loans)
    - Resource intensive tenant management
    - Army has option to "terminate at will"

ICAP ARMS Sub-group

- Addressing:
  - How best to "Grow the ARMS Program":
    - Reduce costs / allow profitability
    - Mitigate / manage risks
- Ongoing initiatives:
  - Standardizing:
    - Business processes (where appropriate)
      - Benefits / savings revenue distribution model
      - ARMS SOW
      - Incorporating incentives
      - Incentive recovery???
    - Policies / regulations
      - 3rd Party Policy/Regulation (17 May 07)
      - ARMS Proposal Process (being coordinated)
      - ARMS Termination Policy (being coordinated)
    - Plant-by-plant assessments
- With approval…how and when do we begin???

Questions / Way Ahead

Back up Chart

Claw Backs

- The product can be purchased, however Several factors will influence the cost of the bond:
  - The state where it will be in force
  - The amount of the bond, the larger the bond the less the cost
  - Deductibles
  - Other terms and conditions as how long after the failure to pay before the bond would be called, Steps the Army and the facility contractor would take prior to calling the bond, etc
  - The perspective tenants credit history
  - The product the tenant plans to produce
- An estimated cost of a $250,000 performance bond / approx. $10,000 per year
- Adjusted either up or down by the factors listed above
- Some perspective tenants my be unable to obtain the bond due to their history
- Facility contractors could get a better rate if it were combined with the overall insurance package they carry (based on the discussions with local vendors)

Risk vs. Reward

ARMS Program	Operating Contractor RISK	Operating Contractor REWARD	Government RISK	Government REWARD
Tenant Leaves	Must guarantee incentive $ are paid back via an Advance Agreement whether tenant is there or not	Operating Cost and/or Product Cost Reduction and some revenue sharing, It varies per Facility Use Contract	Is the improvement and/or tenant business unique? Is it something that the Army can utilize if it can't be commercially filled?	Reduced operating and/or product costs, improved infrastructure - gov't retains the asset
AMC Termination Requirements for ARMS Tenants	Loss of opportunity due to waiver request cycle time.	None	Minimal to None	Army has the ability to Terminate if/when needed
Decreased Incentive Funding	Prog. Dies - Loss of shared revenue & increased operating costs	None	Prog. Dies - Loss of Savings/Benefits	None
Approval Process Cycle Time	Loss of shared revenue for some & increased operating costs	None	Loss of additional savings/benefits	None