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## **Fitch: More US Defense Budget Cuts May Raise Housing Bond Risk.**

Fitch Ratings-New York-15 January 2015: The cuts to the growth in Basic Allowance for Housing (BAH) rates are unlikely to have an immediate impact on taxable military housing bonds at their current levels. However, if the US Department of Defense (DoD) continues cuts in coming years, Fitch Ratings expects that changes in the demand dynamics for privatized military housing transactions could potentially affect those projects' bottom lines and their debt-service coverage levels over time. This was the first time BAH rates have been sized at less than 100% of market rates since 2005.

The bonds or certificates that were issued to finance privatized military housing are commonly secured by a first lien on all receipts from privatized housing on military bases, which can be made up of one or multiple projects and/or bases. The 2015 BAH aggregate rates for military housing rose by 0.5%. Because some of the bases and rank levels were positively impacted and some were negative, the net change for most Fitch-rated transactions will be small. The BAH in higher rent areas, such as California, received sizeable increases, while more rural areas declined.

How the cut is implemented for those residing in on-base privatized housing will play a role in how great an impact there will be on individual project's bottom lines. Service members who receive the BAH are subject to internal rate protection as new BAH rates do not take effect unless the military service member has a change of station and is assigned to another base in 2015. The current BAH rate is grandfathered at the higher level until the service member is sent for permanent duty at another location or moves. Tenant turnover has been estimated at 30% per year.

The potential for further cuts to the BAH through future defense budgets is uncertain, as are annual changes to BAH rates. The DoD has indicated it needs to reduce personnel spending to meet budgetary goals. While the DoD originally intended to cut the BAH by 5%, the current National Defense Authorization Act only cut the BAH by 1% and set rates to cover 99% of the estimated cost of local housing. Personnel costs are more than one-third of the DoD's non-war 2015 budget. In February 2015, the Military Compensation and Retirement Modernization Commissions will deliver their recommendations to Congress, which may include additional cuts.

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