The Soter Group

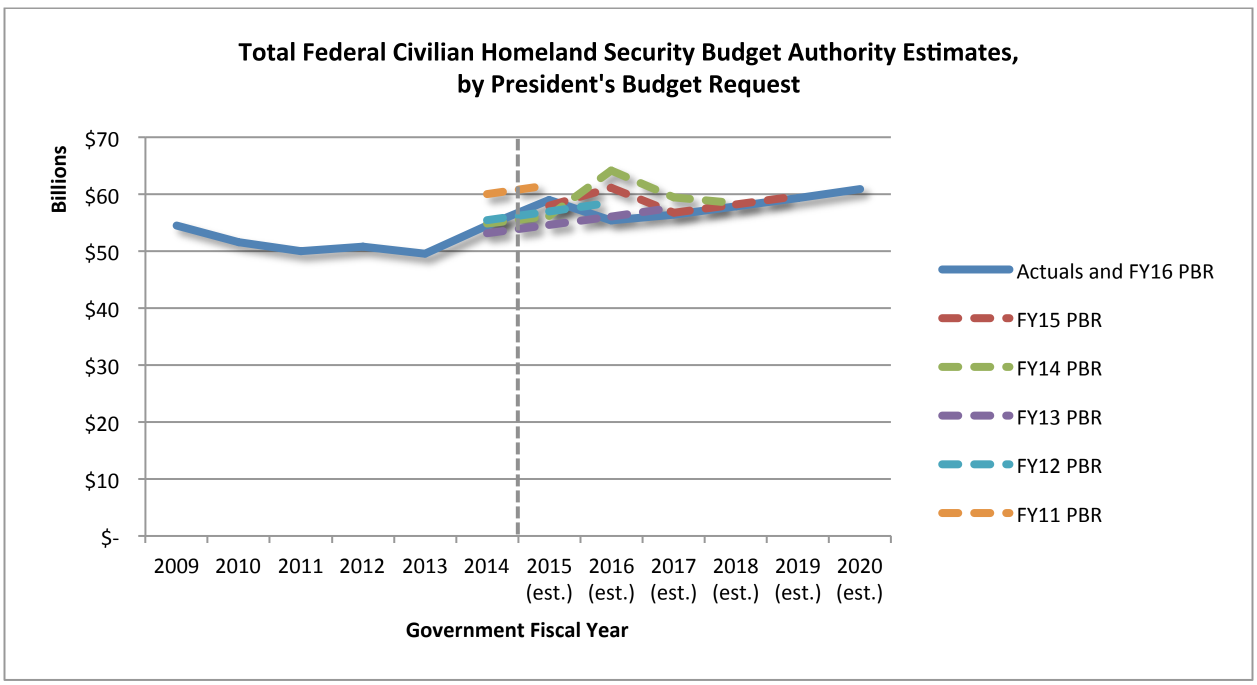
Observations from the 2016 President's Budget Request

At The Soter Group, we have backgrounds and, consequently, particular interest in several topic areas: homeland security, IT, cloud computing, and cyber security. Each February, when the Office of Management and Budget (OMB) releases the new President's Budget Request (PBR), we are always sure to analyze, at the minimum, these portions of the budget. While there are often few surprises, we never want to be caught flat-footed. Will it be business-as-usual for several more years? Are there any large shifts or unexpected changes? Should we be prepared for a more restrictive business environment? Are there upcoming areas of opportunities for which we should position?

This year, we aggregated some of the major observations across these special topic areas while analyzing the troves of budget documents and supporting materials. Access and read our previous report on unclassified Federal cyber security spending in FY14 released March 26, 2015.

Anticipate modest growth in homeland security mission funding

The FY16 PBR projects Federal civilian homeland security mission funding growing to $60.9 billion in FY20 – a mere 3.2% more than current year (FY15) levels. Aside from the forecast for FY16 funding, the current five-year forecast is generally in-line with prior years' five-year forecasts. In fact, it appears that the enacted FY15 budget is markedly higher than previous estimates; meanwhile, the FY16 request is substantially lower than most prior year estimates. For example, compared to last year's forecast, the FY15 budget is approximately $1.0 billion higher while the FY16 request is about $5.8 billion lower.

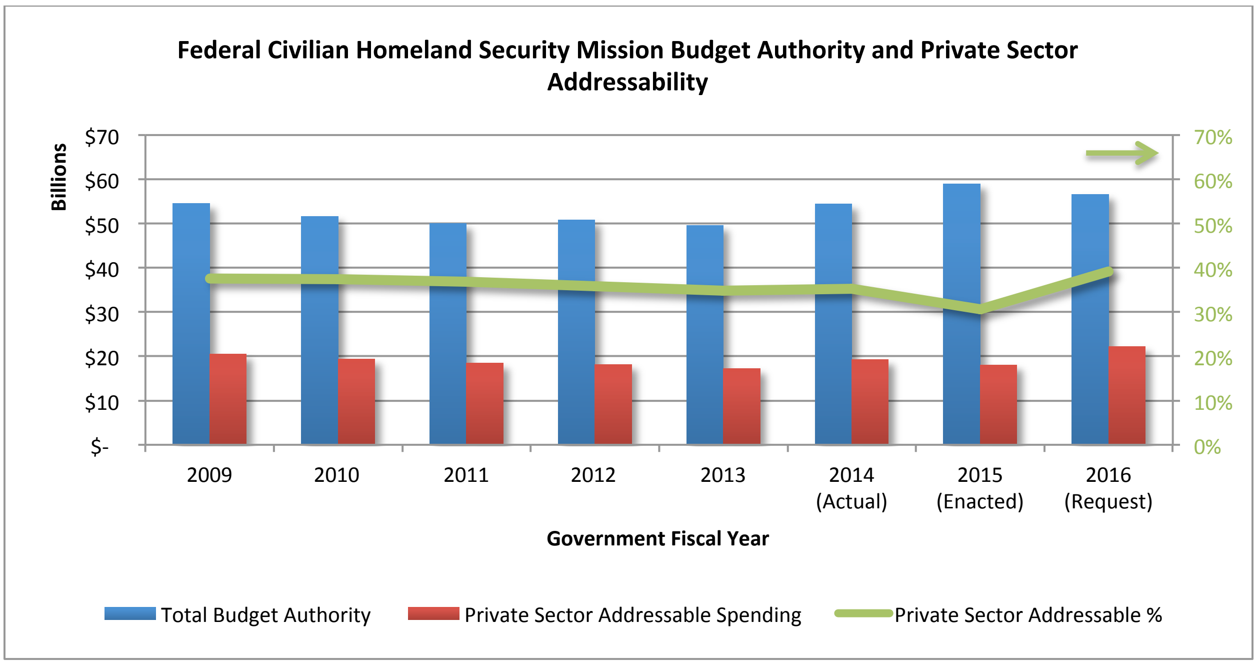


While there are sure to be deviations in year-to-year estimates and actuals versus estimates, the trajectory of outyear budget figures should provide some indications of future priorities and areas of focus. Based on

OMB's current forecast, the Departments of Homeland Security, Justice, and Health and Human Services are expected to be the primary drivers of growth in this market over the next five years. Meanwhile, spending at the other executive branch departments and agencies is projected to remain flat or even decline between FY15 and FY20.

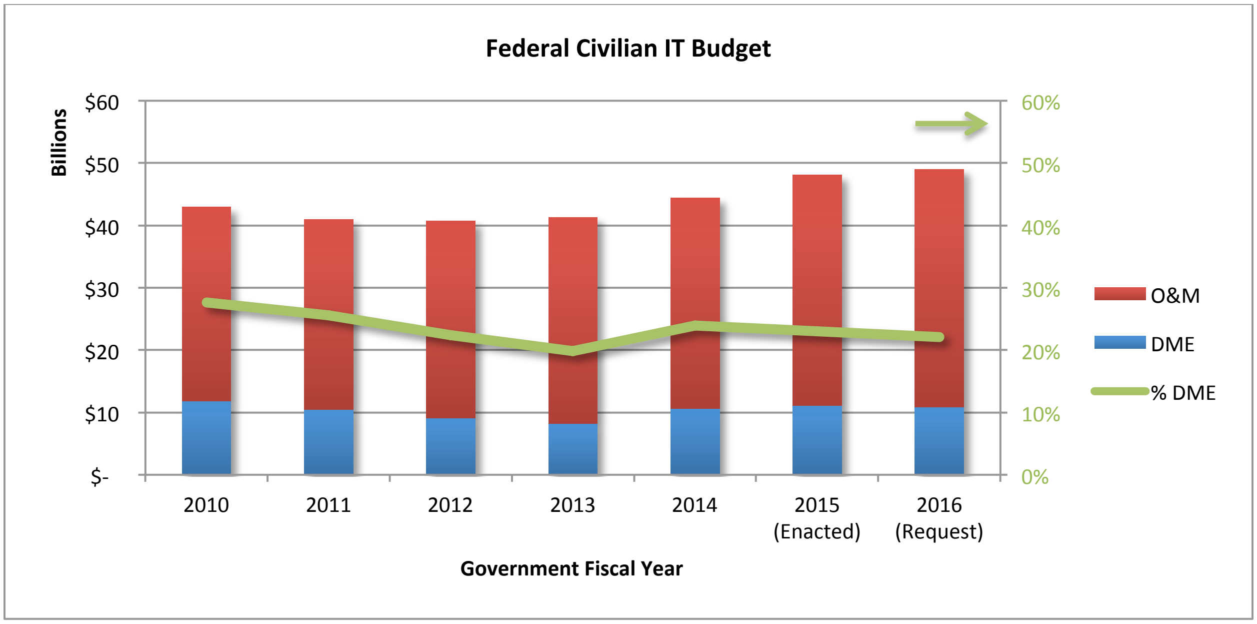
Private sector addressable Federal civilian homeland security market expected to increase in FY16

Spending on homeland security activities within the Federal civilian departments and agencies had been trending downward for numerous years, until a jump in spending in FY14. Compounding this tightening budget environment was a crowding out of private sector addressable spending largely by personnel compensation and benefits. Expected to reach a low of 31% in the current fiscal year (FY15), the private sector addressable portion of the Federal civilian homeland security market is projected to rebound to 39% in the coming fiscal year (FY16). The current budget request suggests an increase of over $4 billion in contractual services and supplies and acquisition of capital assets from the private sector in FY16 versus FY15.



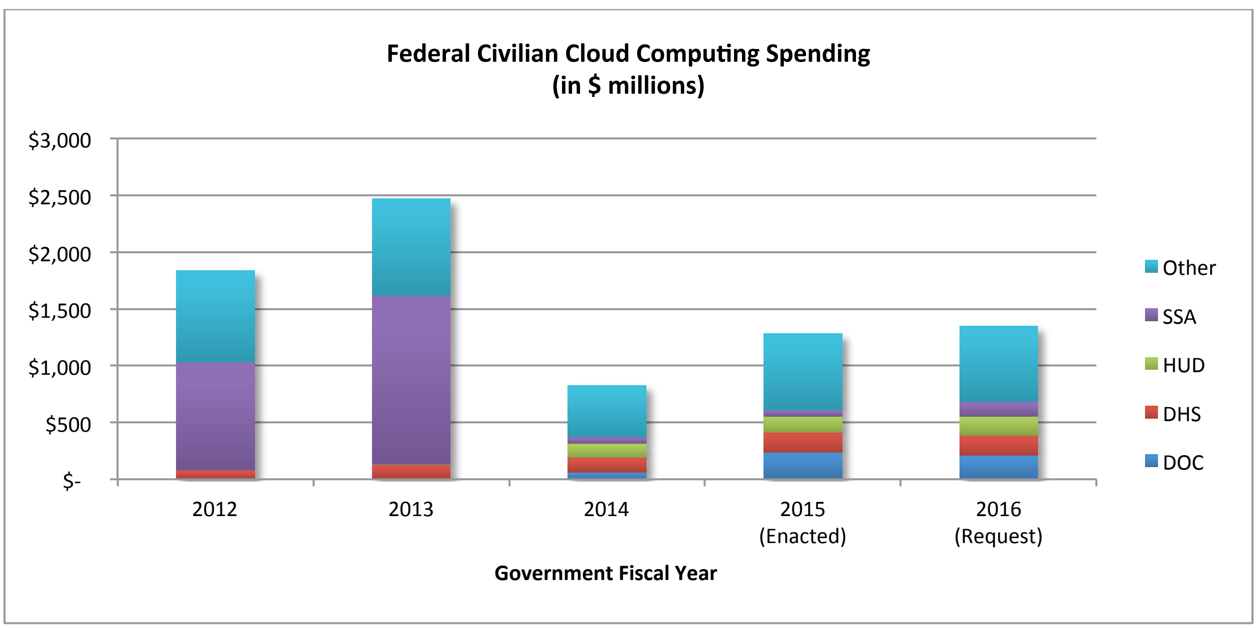
Is Federal Civilian IT Spending Reaching an Inflection Point?

The latest budget shows sizeable growth in Federal civilian spending on IT investments. Reaching a recent low of $40.7 billion in FY12, the Federal civilian IT budget request for FY16 includes $49.0 billion in funding. More notable, however, is that the allocation of funds between development, modernization, and enhancements (DME) and operations and maintenance (O&M) may be reaching a plateau or even an inflection point. Since the mid- to late-2000s, the proportion of funding dedicated to DME had been on a rapid decline, dropping to an estimated 20% in FY13. Unsustainable in the long-term, there are signs that cuts in investment in DME activities may be reaching its end. Increases in DME can lead to more opportunity for contractors who have high-end development capabilities and may make government buyers more open to new, novel solutions and technologies.



Is there a Federal Civilian cloud market or is it just hype and a buzzword?

The Federal civilian cloud market remains a small, but growing, opportunity for the private sector. Out-of-context spending estimates led to overhype within the market. However, with an additional 650 Federal civilian IT investments slated to be reviewed for potential transition to a cloud deployment by the end of FY16, there are expected to be continued growth and an increasing number of opportunities in the near-term. Of the $1.3 billion requested in funding for FY16, over 50% is attributable to the Departments of Commerce (DOC), Homeland Security (DHS), and Housing and Urban Development (HUD), and the Social Security Administration (SSA).



Conclusion

Perhaps most surprising about this year's PBR was that specific, long-lasting trends that we have identified as being unsustainable – much to the detriment of some department and agencies' missions – appear to be reversing, or at least plateauing. While these reversals may be positive and promising for the contracting community writ large, more in-depth due diligence is necessary to really understand how these macro-level trends translate into concrete opportunities at specific customers for particular capabilities.

Note: The Soter Group analysis presented in this article may include both base and supplemental funding. Some figures may deviate from other published numbers due to rounding errors and/or typographical errors in government budget documents. Deviations in funding across fiscal years can be due to programmatic changes and redefinition, reevaluation, and/or reclassification of activities and investments.

About The Soter Group

The Soter Group provides services to both the Federal government and the commercial entities that support it. Our Commercial Services Division provides market research and assessments, competitive assessments, and strategic advisory services to commercial clients seeking to enter or grow in the Federal government security market. Justin Taft, President & CEO, and Peter Wong, Director of Market Research, authored these perspectives. The Soter Group welcomes the opportunity for our research to be cited in third-party reports. To learn more, please visit www.TheSoterGroup.com and/or email info@TheSoterGroup.com.

Report April 2015: Perspectives – Observations from the 2016 President's Budget Request

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Our other reports:

- *Unclassified 2014 Federal Cyber Security Spending Update (March 2015)*
- *Unclassified 2013 Federal Cyber Security Spending (June 2014)*
- *Department of Homeland Security (DHS) Fiscal Year 2013 Contract Funding Fact Sheet (April 2014)*
- *Fiscal Year 2015 Federal Homeland Security Mission Funding (March 2014)*
- *Fiscal Year 2014 Federal Homeland Security Mission Funding (July 2013)*
- *Department of Homeland Security (DHS) Contract Funding, 2008-12 (April 2013)*
- *Department of Defense (DoD) Airborne Intelligence, Surveillance, and Reconnaissance (ISR) Funding – 2013-17 (February 2013)*
- *Fiscal Year 2013 Federal Health IT Funding (December 2012)*
- *Sequestration and Fiscal Year 2013 Federal Homeland Security Mission Funding (September 2012)*
- *Fiscal Year 2013 Federal Homeland Security Mission Funding (March 2012)*

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