

April 30, 2019

The Honorable James Inhofe
Chairman
Senate Committee on Armed Services
228 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Jack Reed
Ranking Member
Senate Committee on Armed Services
228 Russell Senate Office Building
Washington, D.C. 20510

Dear Chairman Inhofe and Ranking Member Reed:

I am writing to provide you with the results of my investigation of the Military Housing Privatization Initiative (MHPI) program and five companies that have contracts with the military services to provide this housing. I opened this investigation on February 6, 2019, amid reports of substandard on-base housing that was having a significant effect on morale and, in some cases, causing severe health problems for military families.

The Committee held a hearing on this matter on February 13, 2019.¹ In addition to asking questions of their executives at the hearing, my staff received briefings from company officials and submitted numerous questions for the record to Department of Defense (DoD) officials and to the private housing companies. On February 6, 2019, I sent an extensive document request to the Corvias Group (Corvias), Balfour Beatty Communities (Balfour), Hunt Military Communities (Hunt), Lincoln Military Housing (Lincoln), and Americas Lendlease Corporation (Lendlease).² The five companies cooperated with the investigation with varying degrees of transparency. Several of them responded in full; others redacted or refused to provide certain key information. The failure of key companies to respond in full raises additional questions about their operations and may warrant additional attention from the Committee.

The remainder of this letter summarizes the results of my investigation. In order to protect confidential business information, as requested by the companies that responded to my request, this letter does not include specific information that would allow for identification of

¹ Senate Armed Services Committee, "Current Condition of the Military Housing Privatization Initiative," February 13, 2019, <https://www.armed-services.senate.gov/hearings/19-02-13-current-condition-of-the-military-housing-privatization-initiative>.

² Letter from Senator Elizabeth Warren to military housing companies, February 6, 2019, <https://www.warren.senate.gov/imo/media/doc/Military%20Housing%20Letters%20ad.pdf>.

individual companies or projects. I would be happy to have my staff brief the Armed Services Committee staff on specific information as requested.

My investigation reaches four main conclusions. Each of the problems I identify can be addressed in whole or in part by legislation I introduced earlier this week, the Military Housing Oversight and Service Member Protection Act. I look forward to working with you and other Committee members to resolve these problems and improve housing quality for service members and their families.

Conclusion One: The private military housing providers have set up a complicated web of subcontractors and subsidiaries that undermines accountability for substandard conditions in military housing and makes it difficult to track revenues, profits, and the flow of funds.

A review of several military housing projects run by private contractors found multiple levels of bureaucracy and numerous subsidiaries or subcontractors (sometimes related to the primary military housing companies) that serve as property managers, general contractors, and developers. This complicated web of affiliates makes it difficult for DoD officials to ensure that quality standards are met and to determine who should be held accountable when they are not. It also means that the flow of Basic Allowance for Housing (BAH) payments that the companies receive as revenue is opaque and difficult to follow. Most if not all of the companies that provided briefings to my office explained that in a typical military housing project, total BAH revenue is primarily and initially spent on operating expenses, payments on debt services, and reinvestment/construction accounts - and only then do they receive any payments (typically 1-2% of BAH revenue). However, the flow of funds to these companies is not limited to this small portion of BAH revenue – since their affiliates and subsidiaries receive payments via operating expenses.

The private housing companies enter into long-term agreements with the military services to create jointly-owned entities responsible for the operation, construction, development, and management of on-base housing projects. However, most of those agreements give the private housing companies “complete, and exclusive discretion to manage and control” the jointly-owned entity, which includes the discretion to establish partnerships. Utilizing this leeway, many of the housing companies hire their own affiliates, subsidiaries, and sub-contractors to develop, operate, and manage housing projects.³ This means that, in addition to the fixed 1-2% of BAH revenue and performance bonuses that the companies receive, they can also retain significant revenues from funds that are used for the construction, day-to-day administration, and development of facilities. In several cases, in briefings, and in the February 2019 SASC hearing

³ Information provided by military housing companies to Sen. Elizabeth Warren.

on military housing, all of the companies described these costs as expenses.⁴ For example, Denis Hickey, Chief Executive Officer of Americas Lendlease Corporation, stated in his written testimony that “ongoing funding for the Project Companies comes in the form of the rent they collect from the residents... [which] is used to pay operating expenses.”⁵ In reality, the documents provided by the housing companies reveal that these operating expenses are often paid directly to subsidiaries and related companies – and are not expenses, but revenues.

For example, one housing company with multiple privatized military housing projects agreed to serve as an integrated asset manager, development manager, and design builder for thousands of single-family rental homes across multiple installations. It also signed property management agreements with a third-party property management company for each of their projects – but a subsidiary of the original housing company retained a non-managing member interest in this secondary agreement. Moreover, the original housing company periodically contracts with its own subsidiaries for design-build or construction related services.⁶

Other companies have similarly intricate partnership agreements. A review of one company’s documents shows that it routinely used up to half a dozen different affiliates and subsidiaries in each of its projects, signing decades-long development, management, and construction agreements with its subsidiaries through the jointly-owned company. In fact, when this company selects its own affiliates to carry out these services, the same company official signed every agreement representing both signatories.⁷

The contracts between the DoD and the housing providers give the companies nearly free reign to select their developers and subcontractors – and to choose their subsidiaries or related entities for these tasks.⁸ The complex interconnectedness of subsidiaries and subcontractors means that it can be difficult to hold the correct companies or officials responsible for military housing when it is in poor condition. It also means that the financial information parent companies report or discuss publicly may not reflect all revenues and profits, or reflect the complete disposition of BAH funds and other sources of income.

⁴ All five of the military housing companies provided briefings to my staff on the structure of their MHPI projects; Senate Armed Services Committee, “Current Condition of the Military Housing Privatization Initiative,” February 13, 2019, <https://www.armed-services.senate.gov/hearings/19-02-13-current-condition-of-the-military-housing-privatization-initiative>.

⁵ Written testimony of Denis Hickey to the U.S. Armed Services Subcommittee on Personnel, Readiness, and Management Support, February 13, 2019, https://www.armed-services.senate.gov/imo/media/doc/Hickey_02-13-19.pdf.

⁶ Information provided by military housing companies to Sen. Elizabeth Warren.

⁷ Information provided by military housing companies to Sen. Elizabeth Warren.

⁸ The Operating Agreement documents reviewed by my office show that the military services need to approve of development, management or construction agreements between the jointly-owned company and any other entities. However, the Operating Agreements ultimately give the private housing companies full, complete, and exclusive discretion to control the jointly-owned company.

Conclusion Two: The private military housing providers have failed to create accessible or centralized records and protocols to address complaints and reports of problems with military housing, which makes comprehensive assessment and oversight of their performance difficult and complicates efforts to improve housing quality.

- a. There are multiple shortfalls and procedural drop off points within the housing providers' systems for housing service requests and resident complaints.**

Each of the companies have their own process for handling housing service requests or complaints, but they generally adhere to the following process: residents are advised to submit a service order either online or in person. A representative from the property management office then tracks and submits the request through a property management software. After a maintenance technician goes to the residence to fix the issue, the property management representative marks the request as resolved or schedules additional maintenance repairs.⁹

But there are a number of flaws with this system. Although the companies are able to see if units have recurring requests in their property management software and can review work order follow-up surveys to determine resident satisfaction, these processes are not always formalized or addressed consistently by the property management representatives, installations, or companies. In fact, one company flatly admitted that it does not maintain a centralized database of complaints at all.¹⁰

The resident complaint process has similar flaws. Typically, the system is designed to allow residents to lodge complaints, anonymously or otherwise, by phone, email, through the project company's websites, a resident hotline, and sometimes even social media. These complaints are routed to the property manager, who then advises the complainant to contact their specific community office. If the community office or resident feels as though the issue was not resolved, some companies allow the resident to escalate the issue to senior leadership. However, the effective resolution or completion of these complaints relies on an oversight mechanism that often is not in place. At least one company indicated that it does not maintain a log that tracks whether complaints received by the company hotline were resolved. These flaws and the companies' failure to track important data can mean that systematic reviews of housing conditions and complaint resolution are exceedingly difficult.¹¹

The information we received about private housing companies' handling of environmental hazards – such as mold, lead paint, or asbestos – in on-base housing also raised concerns. While some housing providers insisted that there are clear procedures in place and that all

⁹ Information provided by military housing companies to Sen. Elizabeth Warren.

¹⁰ Information provided by military housing companies to Sen. Elizabeth Warren.

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environmental health issues were labeled “emergency” in their maintenance protocol, my staff identified no such clear guidance from several of the companies that responded. Companies either lacked clear property maintenance procedures for handling asbestos, mold, and lead in their project or resident agreements (one company only provided residents tips for how residents could protect their homes) or did not tag them in their maintenance logs so they could be identified and tracked.¹² Although some of these issues could be tagged through other maintenance requests (such as HVAC, or heating, ventilation, and air conditioning issues covering mold problems), the failure to clearly and separately identify these problems when they occur means that the existence and frequency of these issues at their installations can be obscured to the service members and their families, property managers, housing companies, installation commanders, and the military services.

My office also received information from multiple whistleblowers regarding processes in place for on-base housing at one Air Force facility. While we were unable to obtain documentary corroboration of the concerns raised by these whistleblowers, the allegations appear to be consistent with some of the problems we identified in this investigation. The whistleblowers allegedly witnessed property management staff purposely log incorrect contact information in their system to ensure that residents that had previously reported issues or expressed complaints to the office would not receive the annual third party professional survey.¹³ These surveys play a key role in determining resident satisfaction and are factored into the company’s annual incentive fee awards.

Similarly, the whistleblowers also alleged that if a resident expressed that they were unsatisfied by their housing in a survey or at the completion of a maintenance request, company employees were instructed to change the “unsatisfied” marking to “satisfied” before it was seen by senior corporate officers. Our office also received allegations from the whistleblowers that indicated that property and leasing managers would intentionally and improperly charge residents for any minor issue they could find when inspecting rooms after residents move out. They alleged that these charges were tied to the bonuses property staff are given at the end of the year.¹⁴

b. There is a lack of clear coordination between the private military housing providers and the military services regarding maintenance requests and housing inspections.

Residents can also raise an issue or concern with their residence or property directly to the military services rather than doing so via the private companies’ property offices. The Interactive Customer Evaluation system, or ICE, allows a resident to submit a complaint about any service or facility on the installation, including housing, to military representatives.¹⁵ Once submitted,

¹² Information provided by military housing companies to Sen. Elizabeth Warren.

¹³ Information provided by whistleblowers to the office of Sen. Elizabeth Warren.

¹⁴ Information provided by whistleblowers to the office of Sen. Elizabeth Warren.

¹⁵ Interactive Customer Evaluation, “About ICE,” https://ice.disa.mil/index.cfm?fa=about_ice&dep=DoD.

the process requires that the complaint is given to project or property company management to handle with “immediate attention” and to resolve in consultation with local installation leadership. However, my staff did not identify company documents or military service contracts that outlined a process for property management to ensure that these complaints or requests are being properly processed, tracked, and addressed in a timely fashion. In fact, information we received from the whistleblowers alleged that military offices at one facility were not doing any ICE request intake or processing at all.¹⁶

The military services are supposed to regularly monitor and assess performance and adherence to project agreements in conjunction with local property and project staff members, though the types and frequency of these processes vary by service. However, based on the documents I requested and received, it is not clear how the results of these audits, investigations, and reports are relayed to key stakeholders, such as company or military officials or service members, and whether there are processes in place to ensure that problems identified via these inspections are appropriately resolved.

One housing company refused to provide a list of the results of inspections in their MHPI facilities since January 1, 2008, and instead responded that “the records of any inspections performed by the DOD or military service personnel are in the possession of the agency/person.”¹⁷ Another indicated that they “do not keep a list of all inspections or their results” and instead provided only one example of a single annual project compliance report they received from the Army. This document did not provide the details that were requested. A review of this document showed problems with both housing company management and with Army oversight even in this cherry-picked report. For instance – after assessing the condition of the community’s infrastructure, the Army report concluded, “neighborhood lighting appeared to be sufficient” – but also indicated that, “lighting was not evaluated for effectiveness because the site visits were conducted during the day.” The report also concludes that “lease files are current with all forms and documents properly completed and filed” – a conclusion it reaches after only having evaluated “2 randomly selected lease files.”

However, even with the limited compliance review revealed that, “several streets were in need of asphalt repairs and/or patching of pot holes” and “most roofs in [one] neighborhood were in need of replacement and have surpassed their life expectancy.” Moreover, the report revealed that the military housing partner was signing 3-5 year agreements with sub-contractors, exceeding “the Army’s standard of no more than 1 year contracts in place” in order to ensure that they are

¹⁶ Information provided by whistleblowers to the office of Sen. Elizabeth Warren.

¹⁷ Information provided by military housing companies to Sen. Elizabeth Warren.

competitively bid and that an army Asset manager – “the Garrison Commander’s chief advisor”¹⁸ - was failing to submit completed Legal Compliance Checklists to his/her superiors.¹⁹

The Legal Compliance Checklists – tools that help “to ensure all parties and the project processes and procedures adhere to the project legal requirements.” – include compliance checks on the Ground Lease, Operating Agreement, Property Management Agreement, Development Agreement and Construction Agreement among a few others. Following these checks, “any items of non-compliance are flagged for follow-up and identified as part of the Quarterly Project Report.” These reports are consolidated into the Army’s Portfolio Compliance Report and play an important role “as a resource for teams negotiating (or re-negotiating) deal structures in the future.” The Asset Manager for this project was completing the required compliance checks. However, the failure of the manager to submit the proper information to superiors interferes with the Army’s ability to identify and resolve consistent program-wide problems and its ability to re-negotiate agreements as necessary.

Other companies provided examples of how some of their military inspections and audits are handled.²⁰ However, my staff did not find documentation or correspondence in these documents that contained information on schedules and deadlines for addressing unresolved problems discovered in the inspections.

My staff also identified failures by the services to provide appropriate communications and oversight. For example, one company’s documents revealed that one of the services sent virtually identical letters to the same company over multiple years commending them on their “exemplary level of environmental conformance” in their environmental compliance audits.²¹ These letters were sent despite the wide range of problems the service noted in these audits – including the lack of information on standard pollution prevention operating procedures and evidence of corrosion, rust, leaks, or pressure bulging in containers.²² In addition, whistleblowers informed my office that, military housing office staff at one base have stopped accompanying project and property representatives when they conducted inspections altogether.²³

This is a significant area of concern. The overlapping responsibilities given to the private housing providers and military services as part of the MHPI program are designed to ensure that residents’ needs are fulfilled and that problems are identified and resolved quickly. When one or

¹⁸ U.S. Army, “Portfolio and Asset Management Handbook,” September 2014, <https://www.rci.army.mil/traininginformation/docs/PAM%20Handbook%20Version%205.0%20Sept%2014%20Reduced%20Size.pdf>.

¹⁹ Information provided by military housing companies to Sen. Elizabeth Warren.

²⁰ Information provided by military housing companies to Sen. Elizabeth Warren.

²¹ Information provided by military housing companies to Sen. Elizabeth Warren.

²² Information provided by military housing companies to Sen. Elizabeth Warren.

²³ Information provided by whistleblowers to the office of Sen. Elizabeth Warren.

both of these responsible parties fail to do their jobs, service members and their families pay a heavy price.

Conclusion Three: Private housing providers are making large profits while taking minimal investment risks.

The private military housing providers have repeatedly claimed that they are highly incentivized to provide high quality housing and are at financial risk if they fail to do so.²⁴ Jarl Bliss, President of Lincoln Military Housing, stated in his written testimony that his company “has strong ethical and economic incentives to deliver the highest level of customer services to service member families because the success of the ... [public private ventures] ... established under the MHPI depends wholly on LMH’s ability to maintain satisfied residents and high occupancy rates in its housing.”²⁵ However, a review of the companies’ financial documents indicate that this may not be the case, and that they can reap significant profit from the projects despite making relatively small investments.

In one project reviewed by my staff, a private housing company invested \$4 million while the military service that housed the project invested \$123 million - over 96% of the cost.²⁶ Over the course of two years, the company received over \$5 million in returns on equity for the project. In another project reviewed by my staff, a private housing company invested just over \$3 million in equity out of \$162 million in total liabilities – less than 2% of total project costs. Yet the company made millions of dollars in profit on this and other projects.²⁷

Company executives and managers are richly rewarded, as shown by the bonuses listed as line items in one of the company’s operating budgets for each of its facilities. Over multiple years, project management leadership bonuses comprised upwards of 20% of their allocated salary budget for the project, and was as high as \$828,000 at one property in 2018.²⁸ In total, this company awarded approximately \$21 million in bonuses for project managers for all projects in the past ten years.²⁹

The military housing companies have indicated that they are making significant investments while taking large risks and earning small profits. But my review indicates that this is not the

²⁴ Senate Armed Services Committee, “Current Condition of the Military Housing Privatization Initiative,” February 13, 2019, <https://www.armed-services.senate.gov/hearings/19-02-13-current-condition-of-the-military-housing-privatization-initiative>.

²⁵ Written testimony of Jarl Bliss to the U.S. Armed Services Subcommittee on Personnel, Readiness, and Management Support, February 13, 2019, https://www.armed-services.senate.gov/imo/media/doc/Bliss_02-13-19.pdf.

²⁶ Information provided by military housing companies to Sen. Elizabeth Warren.

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case. Military housing companies appear to be receiving significant financial returns – even when they fail to provide adequate services to residents.

Conclusion Four: The companies and their subsidiaries are receiving sizeable incentive fees even when they face substantial quality control challenges.

The information that the military housing companies provided to the Committee and to my staff implied that they were retaining only a small percentage of BAH revenues from their housing contracts. However, the companies did not clearly describe their incentive fees – payments based on the company achieving defined quality benchmarks – as profits, which appear to be substantial. These incentive fees are awarded based on a set of metrics that usually include occupancy rates, work order processing, customer service scoring, and financial performance under lender documents (such as meeting debt-service coverage ratios and ability to comply with reserve account funding requirements). These fees are reviewed, adjusted, and approved by DoD personnel or third parties on a regular basis.³⁰ However, some companies can and do receive additional incentive fees through the subsidiaries and affiliates they select to develop and construct military housing.

My staff reviewed several development, construction, and management agreements and found that companies typically receive significant revenue from incentive fees. One housing provider subsidiary that manages an Army installation is eligible to receive 2.5% of the previous month's Net Rental Income for the project as a base management fee - but also 1.75% of the Project's monthly Net Rental Income as an incentive fee.³¹ Over the course of the last decade, that affiliate received over \$23 million in total property management fees from a single installation.³² Moreover, since the company was able to select its own subsidiaries to carry out development and construction services, its other affiliates were also able to collect incentive fees. Its affiliate - selected as the general contractor for the same Army project - is eligible to receive 2% of the cost of work semi-annually as an incentive fee for each month the agreement was in place, in addition to a base fee of 3% of the cost of work.³³ Over the course of the last decade, this affiliate received over \$19 million in fees for this project alone. A third company affiliate selected to develop the same project is eligible to receive a 2% fee for developing and supervising the construction of the project, in addition to a 1.6% annual incentive development fee. It reaped almost \$14.5 million in fees over the last decade.³⁴

In total, one company that provided us with information has received over \$320 million for construction, property management, and development fees over the last decade. This total

³⁰ Information provided by military housing companies to Sen. Elizabeth Warren.

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³⁴ Information provided by military housing companies to Sen. Elizabeth Warren.

excludes any bonuses received by company employees, which are separately drawn from the program's annual budget.³⁵

Incentive fees were included in the housing contracts between the private housing companies and military services to give the private housing companies an extra financial incentive to provide quality living conditions and financially sound properties. However, it appears that even when they fail to do so, the companies still receive significant incentive payments. In response to questions I posed on the issue on February 13, 2019 at a Joint Military Personnel and Readiness Subcommittee hearing, each private housing company executive indicated that the complete withholding of incentive fees has never occurred – even amid widespread evidence of problems.³⁶ In fact, one company that provided a briefing to my staff explained that on average it collects 88% of the 1.5% incentive fee it negotiated in its agreement with the military services.³⁷

My staff's document review indicated that there were notable problems discovered during quarterly and annual reviews of installations that ultimately did not adversely affect incentive fee awards. For example, during one project's evaluation period for 2017, DoD evaluators identified that the company faced a "significant challenge" in completing preventative maintenance (PM) in a timely manner. The report found that one location was "well behind their semi-annual PM schedules at some locations and [that] the number/type of calls after move-in indicate[d] low quality work."³⁸ Other issues included housing contracting delays "mainly due to several errors and omissions discovered in the Construction Documents" as well as "inadequate revenue to fund reserve accounts."³⁹ Each of these concerns affect the financial health of these properties and the wellbeing of military service members and their families. Yet these shortfalls did not prevent the company from receiving \$1.3 million in asset management incentive fees.⁴⁰

Incentive fees are one of the only financial tools that the military services have to ensure that these private housing companies are providing our military families with the living conditions that they deserve. But the services are failing to hold companies accountable, and the private housing providers are retaining millions in incentive fees even when they fall short in fulfilling their contractual obligations.

³⁵ Information provided by military housing companies to Sen. Elizabeth Warren.

³⁶ Senate Armed Services Committee, "Current Condition of the Military Housing Privatization Initiative," February 13, 2019, <https://www.armed-services.senate.gov/hearings/19-02-13-current-condition-of-the-military-housing-privatization-initiative>.

³⁷ Staff briefing provided by military housing company to office of Sen. Elizabeth Warren.

³⁸ Information provided by military housing companies to Sen. Elizabeth Warren.

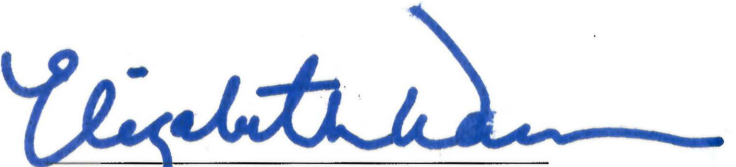
³⁹ Information provided by military housing companies to Sen. Elizabeth Warren.

⁴⁰ Information provided by military housing companies to Sen. Elizabeth Warren.

Conclusion

The nation's service members and their families need and deserve high quality housing, and the documented failures of private housing companies to meet basic standards is unacceptable, hurts families, and damages morale. My investigation has revealed a series of problems and failures in the basic structure of the MHPI program and in the administration and oversight of this program by the private housing companies and the DoD. I have introduced the Military Housing Oversight and Service Member Protection Act to address many of these problems. The bill requires the Department to establish guidance for how it enters and renews housing contracts, and standardizes all lease agreements it signs. It also ensures medical care for affected service members and their families in addition to establishing tenant protections that give them a stronger voice in dealing with these private housing companies. Moreover, the bill creates a new complaint database accessible to all tenants and requires the publication of the financial details of each contract and the financial statement of each housing provider. I look forward to working with you on this legislation and on the FY 2020 National Defense Authorization Act to ensure that military families have the safe, clean housing that they deserve.

Sincerely,



Elizabeth Warren
United States Senator