



May 2021

MILITARY HOUSING PRIVATIZATION

DOD Should Improve Oversight of Property Insurance and Natural Disaster Recovery



A Century of Non-Partisan Fact-Based Work

GAO@100 Highlights

Highlights of [GAO-21-418](#), a report to congressional committees

Why GAO Did This Study

Natural disasters, such as hurricanes and wind and hail storms, have caused millions of dollars in damage to privatized housing at military installations across the United States. GAO has also identified fiscal exposure to climate risks as a High Risk area. Since the mid-1990s, DOD has worked with private developers to construct, maintain, and repair housing at U.S. military installations through partnerships known as privatized housing projects. Damage from natural disasters has raised questions about the financial viability of the affected projects, the insurance they carry, and their funding structure.

The National Defense Authorization Act for Fiscal Year 2020 included a provision that GAO review privatized housing projects affected by natural disasters from December 20, 2016, to December 20, 2019. This report (1) describes how the insurance carried by three privatized housing projects affected their financial viability after natural disasters, and (2) assesses, among other things, the extent to which the military departments and OSD exercised oversight of the projects' property insurance coverage. GAO analyzed damage and financial data on three selected projects; reviewed guidance and insurance documents; and interviewed DOD officials and private developer representatives.

What GAO Recommends

GAO made 7 recommendations in a sensitive version of this report, including that the military departments improve their insurance review oversight procedures. DOD concurred with the recommendations.

View [GAO-21-418](#). For more information, contact Elizabeth Field at (202) 512-2775 or fielde1@gao.gov.

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DOD Should Improve Oversight of Property Insurance and Natural Disaster Recovery

What GAO Found

This is a public version of a sensitive report that GAO issued in February 2021. Much of the business and financial information in GAO's February 2021 report has been omitted because it was deemed sensitive by DOD.

The property insurance carried by three Department of Defense (DOD) privatized housing projects that GAO reviewed covered most of the natural disaster losses from December 2016 to December 2019. However, the extent of the losses at Tyndall Air Force Base, Florida, and Marine Corps Base Camp Lejeune, among other installations in North Carolina, created financial challenges for those installations' respective privatized housing projects. These challenges relate to the extent of the shortfalls between net expected insurance proceeds compared to estimated repair costs. The military departments and private developers responsible for these projects have taken, or are engaged in, actions to support their respective projects' natural disaster recovery.

Natural Disaster Damages at Homes on Installations of Three Selected Privatized Housing Projects



Tyndall Air Force Base, Florida (2018)
Damage from Hurricane Michael



Marine Corps Base Camp Lejeune,
North Carolina (2018)
Damage from Hurricane Florence^a



Fort Carson, Colorado (2017 / 2018)
Damage from wind and hail storms

Source: GAO analysis of Department of Defense information (text); U.S. Air Force/Staff Sgt. Ryan Conroy (Tyndall); U.S. Marine Corps/Lance Cpl. Colton Brownlee (Camp Lejeune); Fort Carson Public Affairs Office/Amber Martin (Fort Carson). | [GAO-21-418](#)

^aDamage also occurred at Marine Corps Air Station Cherry Point and Marine Corps Air Station New River, North Carolina, which are part of the same privatized housing project as Marine Corps Base Camp Lejeune.

GAO found that the military departments have exercised insufficient oversight of their privatized housing projects' property insurance coverage, and the Office of the Secretary of Defense (OSD) has not regularly monitored the military departments' implementation of insurance requirements.

- The military departments have conducted reviews of private developers' property insurance for selected projects, but their procedures would benefit from improvements. For example, the Air Force did not have procedures for requiring timely resolution of any discrepancies between insurance coverage and requirements. Further, the Navy has not documented its conducted insurance reviews.
- OSD has not regularly monitored the military departments' implementation of insurance requirements, including the results of their insurance reviews. However, while a draft of a sensitive version of this report was with DOD for comment, OSD issued a new policy memorandum, effective January 2021, requiring such regular insurance reporting. Effective implementation of this action should improve DOD's oversight of privatized housing projects.

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Abbreviations

AETC	Air Education and Training Command
AMCC	Atlantic Marine Corps Communities
DOD	Department of Defense
OMB	Office of Management and Budget
OSD	Office of the Secretary of Defense

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May 20, 2021

The Honorable Jack Reed
Chairman
The Honorable James M. Inhofe
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Adam Smith
Chairman
The Honorable Mike Rogers
Ranking Member
Committee on Armed Services
House of Representatives

Natural disasters, such as hurricanes and wind and hail storms, have caused millions of dollars in damages to privatized housing at military installations across the United States. Specifically, from December 2016 to December 2019, according to Department of Defense (DOD) estimates, housing privatized under DOD's Military Housing Privatization Initiative¹ experienced millions of dollars in damage as a result of natural disasters. Further, after decreasing 17 percent on average from October 2016 to September 2017, property insurance prices in the United States have increased 105 percent on average from October 2017 to June 2020, according to Marsh's *Global Insurance Market Index*.² Moreover, disaster costs are projected to increase as extreme weather events become more frequent and intense.³ These costs, among other things, have raised

¹National Defense Authorization Act for Fiscal Year 1996, Pub. L. No. 104-106, §§ 2801-2841 (1996), *codified as amended at* 10 U.S.C. §§ 2871-2894a. In this report we refer to housing privatized under the Military Housing Privatization Initiative as privatized housing.

²Marsh, *Global Insurance Market Index—Q2 2020* (August 2020).

³GAO has identified fiscal exposure to climate risks as a High Risk area. See GAO, *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas*, [GAO-19-157SP](#) (Washington, D.C.: Mar. 6, 2019).

questions about the financial viability of the affected projects, the insurance they carry, and their funding structures.⁴

Since the mid-1990s, DOD has worked with private-sector developers and property management companies, hereafter referred to as private developers, to construct, renovate, maintain, and repair housing at U.S. installations through partnerships known as privatized housing projects.⁵ We have previously reported on the challenges DOD has faced in its financial management and oversight of privatized housing. In 2018, we reviewed the financial condition of DOD's privatized housing projects and found that DOD needed to take steps to improve monitoring, reporting, and risk assessment.⁶ Specifically, we recommended that DOD revise guidance to improve the consistency and comparability of the information reported on the financial condition of its privatized housing projects, fully assess the effects of reductions in basic allowance for housing on the projects, and define tolerances for project risks.⁷ DOD concurred with our recommendations and has taken steps to address them. For example, in August 2018, DOD revised its reporting guidance to the military

⁴Projects' funding structures, also known as cashflow waterfalls, describe how incoming funds are allocated to project accounts—such as operating expenses.

⁵Privatized housing projects are run by a private-sector partner. For the purposes of this report, we refer to this partner as a developer or developers. Developers are alternately referred to by the military departments as project owners, private partners, or managing members. Developers may also be referred to as a lessor of a privatized housing project in their capacity as landlord to the servicemembers who rent the privatized housing.

⁶GAO, *Military Housing Privatization: DOD Should Take Steps to Improve Monitoring, Reporting, and Risk Assessment*, [GAO-18-218](#) (Washington, D.C.: Mar. 13, 2018).

⁷DOD's Office of the Deputy Assistant Secretary of Defense for Military Personnel Policy annually calculates rent and utility rates for locations across the United States based on estimates of local market conditions, which are then adjusted for an individual's pay grade and dependency status. These calculations, which can fluctuate from year to year, are then used to determine individual servicemembers' monthly basic allowance for housing. Servicemembers' rent is paid—whether living on the installation or off—with basic allowance for housing payments. We recently reported on DOD's process for calculating basic allowance for housing rates. See GAO, *Military Housing: Actions Needed to Improve the Process for Setting Allowances for Servicemembers and Calculating Payments for Privatized Housing Projects*, [GAO-21-137](#) (Washington, D.C.: Jan. 25, 2021).

departments to ensure that financial data were consistent and comparable.⁸

In 2020, we reported on several issues concerning how DOD and the military departments collected and reported financial and maintenance data, measured performance, and exercised oversight of privatized housing.⁹ We recommended that DOD provide updated guidance for the oversight of privatized housing and assess the risks of proposed initiatives on the financial viability of the projects. DOD concurred with our recommendations and, as of 2020, was working to address them. For example, DOD planned to issue a policy requiring the assessment of project financial viability as part of quarterly program reviews. A list of our related products is included at the end of this report.

The National Defense Authorization Act for Fiscal Year 2020 included a provision that we review privatized housing projects affected by extreme weather events or other natural disasters from December 20, 2016, to December 20, 2019.¹⁰ In this report, we 1) describe how the insurance carried by three privatized housing projects affected their financial viability following natural disasters, and examine the extent to which 2) the military departments took action to approve projects' use of funds to support natural disaster recovery, and 3) the military departments and Office of the Secretary of Defense (OSD) exercised oversight of projects' property insurance coverage.

This report is a public version of a sensitive report that we issued in February 2021.¹¹ DOD deemed much of the information in that report to

⁸The military departments are the Department of the Army, Department of the Air Force, and Department of the Navy. The Department of the Navy includes the Navy and the Marine Corps.

⁹GAO, *Military Housing: DOD Needs to Strengthen Oversight and Clarify Its Role in the Management of Privatized Housing*, [GAO-20-281](#) (Washington, D.C.: Mar. 26, 2020).

¹⁰Pub. L. No. 116-92, § 3016 (Dec. 20, 2019). The U.S. Global Change Research Program has defined extreme weather events as those that are rare at a particular place and time of year, including, for example, heat waves, cold waves, heavy rains, periods of drought and flooding, and severe storms. The Department of Homeland Security defines natural disasters as all types of severe weather, which have the potential to pose a significant threat to human health and safety, property, critical infrastructure, and homeland security. For the purposes of this report, we refer to all extreme weather events or other natural disasters as natural disasters.

¹¹GAO, *Military Housing Privatization: DOD Should Improve Oversight of Property Insurance and Natural Disaster Recovery*, [GAO-21-184SU](#) (Washington, D.C.: Feb. 18, 2021).

be sensitive, which must be protected from public disclosure. Therefore, this report omits sensitive business and financial information. Although the information provided in this report is more limited, the report addresses the same objectives as the sensitive report and uses the same methodology.

For this report, we selected the three privatized housing projects that experienced natural disasters in our December 2016 to December 2019 timeframe (hereafter, our timeframe) that could potentially have impacted their financial viability. We found that the natural disasters experienced by the three following military housing projects during our timeframe resulted in significant damage costs: (1) Air Education and Training Command (AETC) Group I (various locations across the southern United States, including Tyndall Air Force Base); (2) Atlantic Marine Corps Communities (AMCC) (various locations along the East Coast, including Marine Corps Base Camp Lejeune); and (3) Fort Carson (Colorado).¹² Our selection of these projects was informed by interviews with and data provided by OSD and the military departments on projects affected by natural disasters within our timeframe. We also reviewed OSD and military department policies and guidance related to the implementation of the privatized housing program and interviewed OSD and military department officials and representatives from the two private developers—Balfour Beatty Communities (hereafter, Balfour Beatty) and Lendlease—that are currently responsible for our selected privatized housing projects.¹³ Balfour Beatty is the private developer for the AETC Group I and Fort Carson projects. Lendlease is the private developer for the AMCC project. Further, we received written responses from the Office of Management and Budget (OMB) on its role in DOD's privatized housing program.

For objective one, we collected and analyzed data from the military departments and private developers on the estimated damage costs, property insurance coverage amounts, and length of the claims process for the natural disasters that caused the most damage at the selected projects.¹⁴ We also collected and analyzed financial data from the military departments and private developers on the selected projects, including

¹²See figure 2 for the locations of the projects' installations, as well as the military departments responsible for their oversight.

¹³Privatized housing projects are run by a lead developer. For the purposes of this report, we refer to this developer as the private developer.

¹⁴For the purposes of this report, we focused on property insurance because the selected projects filed property insurance claims for natural disaster damages.

insurance premiums, annual net income or loss, and annual debt coverage ratios—a measure of the cash flow available to pay debt obligations. We reviewed business agreements between the military departments and the private developers to identify insurance coverage requirements, as well as loan and insurance coverage documents for the selected projects to identify insurance coverages carried by the projects for natural disasters. We also reviewed documentation describing the long-term financial effects of the natural disasters on these projects and actions the military departments and private developers are considering to address any challenges.

For objective two, we reviewed information on actions the selected projects, OSD, the military departments, and OMB took to support natural disaster recovery. Specifically, we reviewed legal agreements and financial transaction documents to determine how the projects used their account funds to support natural disaster recovery. Based on an action taken by the Army, we determined that the control activities component of the *Standards for Internal Control in the Federal Government* was significant to this objective, along with the associated underlying principle that management should implement control activities through policies.¹⁵ We compared Army policies and practices for managing the movement of funds with this principle. Specifically, we identified a control activity that the Army used to manage the movement of Fort Carson’s account funds and reviewed the Army’s relevant policy to determine if the activity was captured in the policy.

For objective three, we evaluated military department reviews of property insurance coverage for each selected project against requirements for oversight and assessing risk in the military departments’ housing guidance. We determined that the risk assessment component of the *Standards for Internal Control in the Federal Government* was significant to this objective, along with the associated underlying principle that management should identify, analyze, and respond to significant changes that could impact the internal control system. We compared the actions taken by the military departments to this principle.¹⁶ Specifically, we identified internal control actions taken by each military department to determine if they fully assessed the risks related to the projects’ property insurance coverage. Further, we interviewed OSD privatized housing

¹⁵GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

¹⁶[GAO-14-704G](#).

officials on the extent to which OSD exercised oversight of the projects' property insurance coverage and assessed OSD's responses against its responsibilities outlined in DOD's housing management policy.

To assess the reliability of the data sources used to conduct our analyses, we compared some of the sources we used to other sources, such as the projects' audited financial statements or other financial records, and interviewed military department officials and private developer representatives responsible for the projects' finances to corroborate the values. We found the data we used to be sufficiently reliable for the purposes of our reporting objectives.

We conducted this performance audit from March 2020 to February 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We subsequently worked with DOD from February 2021 to May 2021 to prepare this publicly releasable version of the original sensitive report. This public version was also prepared in accordance with these standards.

Background

Military Housing Privatization Authorities and Project Structures

DOD's policy is to ensure that eligible personnel and their families have access to affordable, quality housing facilities and services consistent with grade and dependent status, and that the housing generally reflects contemporary community living standards.

Military Housing Privatization Initiative. In 1996, Congress enacted the Military Housing Privatization Initiative (hereafter, privatized military housing program) in response to DOD concerns about the effect of inadequate and poor quality housing on servicemembers and their

families.¹⁷ Since then, private developers have assumed primary responsibility for military family housing in the United States. They are currently responsible for the construction, renovation, maintenance, and repair of about 99 percent of domestic military housing—more than 200,000 homes on and around military bases—in the continental United States, Alaska, and Hawaii.¹⁸ Privatized housing is owned by each project's respective private sector entity.

Various authorities for private-sector financing and management.

From the inception of the privatized military housing program, the military departments were provided with various authorities to obtain private-sector financing and management to repair, renovate, construct, and operate military housing in the United States and its territories. These authorities include the ability to make direct loans to and invest limited amounts of funds in projects for the construction and renovation of housing units for servicemembers and their families.¹⁹ The projects were generally financed through both private-sector financing, such as bank loans and bonds, and funds provided by the military departments. The Army and the Navy generally structured their privatized housing projects as limited liability companies in which the military departments formed partnerships with the private developers and invested funds in the

¹⁷DOD does not require servicemembers, other than certain key personnel and junior unaccompanied personnel, to live on an installation. About a third of eligible servicemembers generally live in military housing and are provided with a basic allowance for housing to cover their living expenses. The basic allowance for housing payment is designed to enable servicemembers to live off-base comparably to their civilian counterparts. Therefore, DOD's privatized housing competes with available housing options in the local market. Active-duty servicemembers are given priority for privatized housing. However, projects can advertise and lease to tenants other than active-duty servicemembers, including civilians in some cases, once occupancy falls below a specific level. For example, the Air Force has approved leasing to other tenants when any given project's occupancy rate falls below 98 percent.

¹⁸The Military Housing Privatization Initiative authorities also have been used to privatize some unaccompanied housing assets and temporary lodging facilities in the United States.

¹⁹The authorities also provided DOD with the ability to provide loan and rental guarantees, make differential lease payments, and convey or lease property or facilities to eligible entities, among other things.

partnership.²⁰ In contrast, the Air Force generally provided direct loans to the privatized housing projects.

Because privatized housing projects involve budgetary commitments of the federal government, each project was scored at inception by OMB to determine the amount of funds that needed to be budgeted by the military department for that particular project.²¹ OMB is also responsible for ensuring that the direct loans are managed in accordance with OMB guidance.²²

Military departments have flexibility to structure privatized housing projects. The military departments have flexibility in how they structure their privatized housing projects, but typically the military departments lease land to the private developers for a 50-year term and convey existing housing located on the leased land to the developer for the duration of the lease.²³ The private developer then becomes responsible for renovating and constructing new housing and for the daily management of the housing units. As of June 2020, 14 private developers were responsible for 79 privatized military family housing projects—34 for the Army, 32 for the Air Force, and 13 for the Navy and the Marine Corps.²⁴

Each privatized housing project is a separate and distinct entity governed by a series of legal agreements that are specific to that project, hereinafter referred to as business agreements.²⁵ These business agreements include, among other things, an operating agreement, a

²⁰A limited liability company is a company in which the liability of each shareholder or member is limited to the amount individually invested.

²¹OMB uses scoring to determine the amounts to be recognized in the budget when an agency signs a contract or enters into a lease.

²²See OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget* (July 2020) and OMB Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables* (January 2013) for associated guidance.

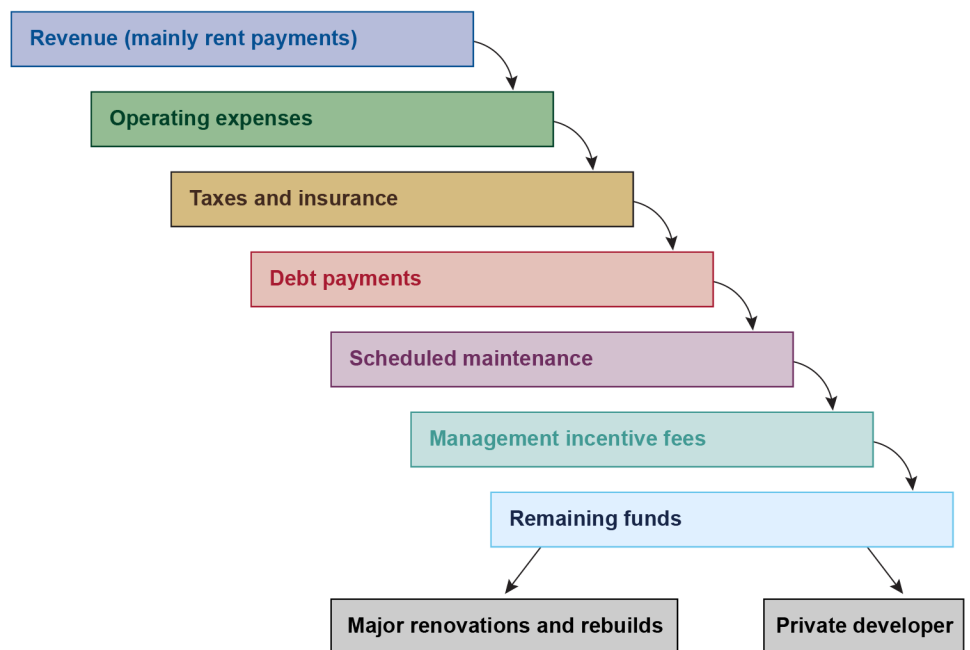
²³The proposed project structure requires OSD and OMB approval, according to an OSD official.

²⁴Additionally, 5 private developers were responsible for 7 unaccompanied housing projects—5 for the Army and 2 for the Navy, while 1 private developer was responsible for 1 privatized lodging project for the Army. We are separately reviewing the Army's privatized lodging program and expect to report on it in spring 2021.

²⁵Business agreements are alternately referred to as transaction documents or closing documents.

property management agreement, and an agreement that describes the management of funds in the projects, including the order in which funds are allocated within the project. However, while each project is distinct, there are some common elements in how projects invest and use funds. Every project takes in revenue, which consists mostly of rent payments. Projects then pay for operating expenses, including administrative costs, day-to-day maintenance, management base fees, and utilities, among other things. After that, projects generally allocate funds for taxes and insurance, followed by debt payments. Figure 1 shows a typical funding structure for a privatized housing project.

Figure 1: Typical Funding Structure for a Privatized Housing Project



Source: GAO analysis of Department of Defense information. | GAO-21-418

Note: If a project has received a loan from the government—as is the case with many Air Force projects—the next use of funds is the payment on the government loan debt. This step is not depicted in figure 1, as Army and Navy projects generally do not include government loans.

In the typical privatized housing project depicted in figure 1, once debt payments are made, funds are allocated to accounts that fund scheduled maintenance, such as repair and replacement of items like roofs, heating

and cooling systems, and infrastructure.²⁶ After that, funds are allocated to one or more management incentive fees, such as the property management incentive fee. Finally, the project divides these remaining funds according to a fixed percentage between accounts that (1) fund major renovations and rebuilds and (2) are provided to the private developer. The percentages may vary across agreements, but according to military department documentation, the majority of funds typically go toward the accounts funding major renovations and rebuilds—known as reinvestment, recapitalization, or sustainment accounts.

The business agreements for our selected projects also include requirements for the private developers to obtain insurance coverages for the project, including property insurance coverage. The property insurance requirements vary by project, but some are common across projects. Examples of common property insurance requirements for our selected privatized housing projects include (a) coverage for damage from disasters (e.g., fire, flood, earthquake, windstorm, and hail storm); (b) 100 percent full replacement value; (c) business interruption insurance or loss of rent; and (d) notice of a material change or cancellation of coverage. Additionally, the business agreements for our selected privatized housing projects require the private developer to obtain property insurance coverage at a commercially reasonable rate.

DOD Roles and Responsibilities in the Privatized Housing Program

The Assistant Secretary of Defense for Sustainment, as DOD's Chief Housing Officer, is responsible for the oversight of privatized housing units, including the creation and standardization of housing policies and processes.²⁷ According to DOD officials, the Deputy Assistant Secretary of Defense for Housing, under the authority, direction, and control of the Assistant Secretary of Defense for Sustainment, is responsible for all matters related to the privatized housing program and is the program manager for all DOD housing, whether DOD-owned, DOD-leased, or privatized.²⁸ In this capacity, the Deputy Assistant Secretary is to provide both guidance and general procedures related to housing privatization, as

²⁶If a project has received a loan from the government—as is the case with many Air Force projects—the next use of funds is the payment on the government loan debt. This step is not depicted in figure 1, as Army and Navy projects generally do not include government loans.

²⁷10 U.S.C. § 2890a.

²⁸Almost all DOD family housing in the United States has been privatized; however, DOD is responsible for overseas family housing and most housing for unaccompanied military personnel in the United States.

well as required annual reports to Congress on privatized housing projects.²⁹ However, it is the responsibility of the military departments to execute and oversee the privatized housing projects, including conducting financial management and monitoring their portfolio of projects. Each military department has issued guidance that outlines its responsibilities for privatized housing, such as which offices are responsible for overseeing privatized housing projects.³⁰

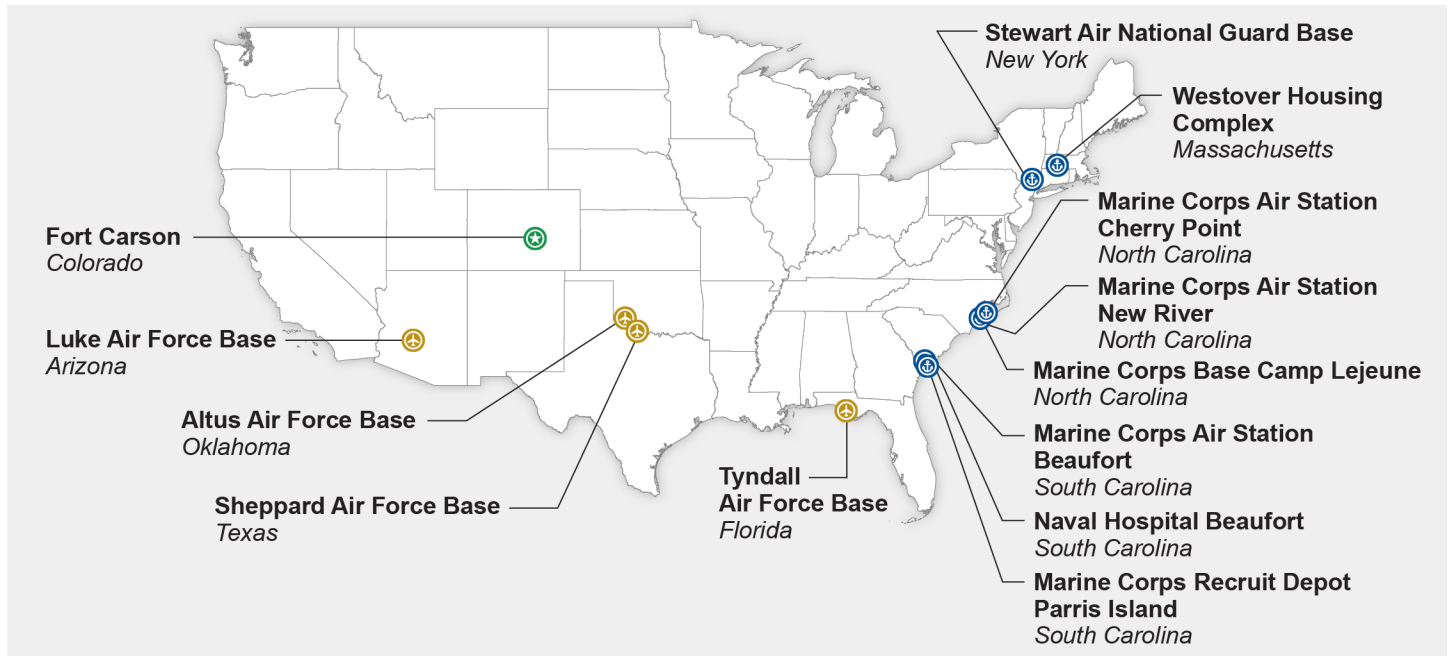
Selected Privatized Housing Projects




Figure 2 shows the locations of the three privatized housing projects we selected for this review, the military departments responsible for their oversight, and the installations that constitute each project. As shown, privatized housing projects can consist of some or all of the housing at one installation, or some or all of the housing at multiple installations grouped into one project.

²⁹Section 2884(c) of Title 10 of the United States Code requires the Secretary of Defense to report semiannually an evaluation of the status of oversight and accountability measures for housing privatization projects, including, among other things, information about financial health and performance and the backlog of maintenance and repair. According to DOD officials, although the statute requires semiannual reporting, due to the effort involved, DOD aims to produce one report for each fiscal year, rather than two.

³⁰Air Force Instruction 32-6000, *Housing Management* (Mar. 18, 2020); Department of the Army, *Portfolio and Asset Management Handbook: Residential Communities Initiative*, ver. 6.0 (Dec. 26, 2019); Commander, Navy Installations Command Notice 11101, *Navy Privatized Family Housing Oversight* (Feb. 4, 2020); and Commander, Marine Corps Installations Command Policy Letter 1-20, *Marine Corps Privatized Family Housing Oversight* (June 16, 2020).

Figure 2: Locations of Selected Privatized Housing Projects



-  Fort Carson; Department of the Army; Balfour Beatty Communities
-  Atlantic Marine Corps Communities; Department of the Navy; Lendlease
-  Air Education and Training Command Group I; Department of the Air Force; Balfour Beatty Communities

Source: MapInfo; GAO analysis of Department of Defense information. | GAO-21-418

Property Insurance Covered Most Natural Disaster Losses, but the Extent of Losses Created Financial Challenges for Two Privatized Housing Projects

The property insurance carried by the privatized housing projects we reviewed covered most of the losses they sustained as a result of natural

disasters, but will not provide all needed recovery funding.³¹ As shown in figure 3, the three privatized housing projects we selected incurred significant losses from natural disasters from December 2016 through December 2019. Specifically, the extent of the losses at Tyndall Air Force Base, Florida, and Marine Corps Base Camp Lejeune, among other installations in North Carolina, created financial challenges for those installations' respective privatized housing projects. Our sensitive report included a more detailed discussion of our three selected projects' financial information. Discussion of this information has been omitted because it was deemed sensitive by DOD.

Figure 3: Natural Disaster Damages at Homes on Installations of Selected Privatized Housing Projects



Tyndall Air Force Base, Florida (2018)
Damage from Hurricane Michael



Marine Corps Base Camp Lejeune, North Carolina (2018)
Damage from Hurricane Florence^a



Fort Carson, Colorado (2017 / 2018)
Damage from wind and hail storms

Source: GAO analysis of Department of Defense information (text); U.S. Air Force/Staff Sgt. Ryan Conroy (Tyndall); U.S. Marine Corps/Lance Cpl. Colton Brownlee (Camp Lejeune); Fort Carson Public Affairs Office/Amber Martin (Fort Carson). | GAO-21-418

^aDamage also occurred at Marine Corps Air Station Cherry Point and Marine Corps Air Station New River, North Carolina, which are part of the same privatized housing project as Marine Corps Base Camp Lejeune.

While the insurance coverages for the three projects we reviewed were, according to military officials and private developer representatives, comparable to those required by commercial lenders for natural disasters, the insurance payouts will not provide all funding needed to restore and rebuild the housing units. The shortfall between the net expected insurance proceeds compared to the amount of estimated repair costs

³¹The projects are required under their agreements with the military departments to carry property insurance, which also includes business interruption—or loss of income—insurance. The terms of each of the projects' property insurance policies—such as the premiums, limits, and deductibles—vary and depend to some degree upon insurance market conditions at the time of their annual renewal.

varied across the three projects we reviewed. The financial challenges faced by these projects were related to the extent of the shortfalls.

According to representatives from Balfour Beatty—the private developer for AETC Group I and Fort Carson—the claims process consists of several phases, which include: 1) the private developer requests advance payment from the insurer to cover emergency expenses, although there is no obligation on the part of the insurer to provide such payment; 2) a scope of work and estimated restoration costs are developed; 3) contractors are selected and, once authorized by the insurer, complete the work; and 4) the work is inspected by an insurance adjuster and reviewed for final payment. This process may be repeated multiple times as damage is assessed in housing across different neighborhoods, according to representatives from Balfour Beatty.

This claims process for receiving insurance proceeds can take a significant amount of time, and according to private developer representatives, insurance funding delays are not uncommon, especially in large-scale events. For example, Air Force officials told us that the AETC Group I project has experienced substantial delays receiving insurance proceeds. Balfour Beatty representatives and Air Force officials told us that they are still working through the claims process to receive additional insurance proceeds.

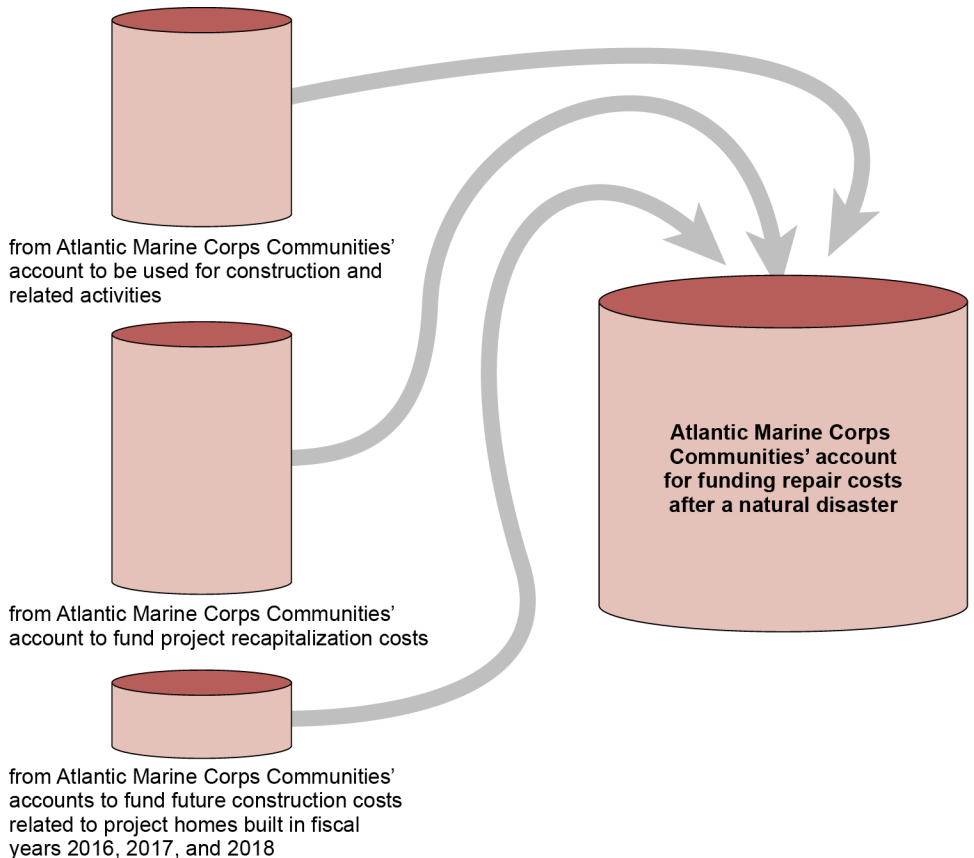
Projects Moved Funds and Delayed Payments to Support Natural Disaster Recovery, but Army and Air Force Actions Had Shortcomings

We found that each of the military departments took actions involving the privatized housing projects' funding structures—to include approving the movement of funds among accounts—to support their respective projects' natural disaster recovery. We found that the Navy approved the movement of some of AMCC's project funds to support natural disaster recovery. However, we found shortcomings in the Army's approval of moving some of Fort Carson's project funds and with one of the Air Force's funding actions to aid AETC Group I's disaster recovery. Our sensitive report included a more detailed discussion of our three selected projects' financial information. Discussion of this information has been omitted because it was deemed sensitive by DOD.

Navy. Due to the extensive damage from Hurricane Florence to several installations that are part of the AMCC project, in August 2019 Lendlease requested, and the Navy approved, the transfer of funds from three of AMCC's accounts designated for future construction and recapitalization to an account for funding hurricane repair costs (see fig. 4). Lendlease representatives told us that the movement of these funds enabled the

project to repair more homes and avoid the possibility of a debt service shortfall.

Figure 4: Atlantic Marine Corps Communities' Movement of Funds from Three Different Accounts to Support Hurricane Florence Natural Disaster Recovery

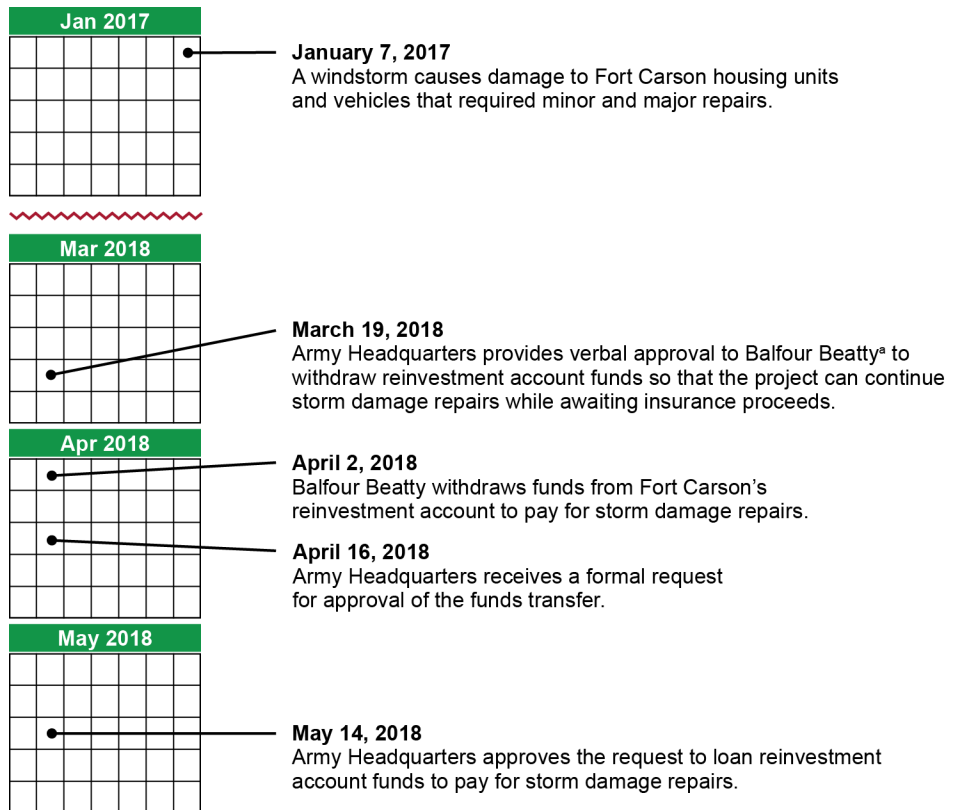


Source: GAO analysis of Department of the Navy information. | GAO-21-418

Note: Atlantic Marine Corps Communities is a military privatized housing project that includes housing at several installations, such as Marine Corps Base Camp Lejeune and Marine Corps Air Station Cherry Point.

Army. In an effort to quickly respond to windstorm damage sustained at Fort Carson, Colorado, the Army provided verbal authorization—but did not provide written approval when required—for Fort Carson's private developer—Balfour Beatty—to move funds among the project's accounts (see fig. 5).

Figure 5. Timeline of Department of the Army Approval to Use Fort Carson, Colorado, Reinvestment Account Funds to Support Natural Disaster Recovery



Source: GAO analysis of Department of the Army and Balfour Beatty Communities information. | GAO-21-418

Note: A reinvestment account fund is used to fund major housing renovations and replacements.

^aBalfour Beatty Communities is the private developer for the Fort Carson military privatized housing project.

According to the Army's privatized housing handbook in effect at the time of this action, this action constituted a "Higher Authority Major Decision," and any such Major Decision required the written signature of a specific approving authority at higher headquarters prior to implementation of the project.³² However, the funds were withdrawn on April 2, 2018, based only on verbal approval of the Deputy Assistant Secretary of the Army for

³²Department of the Army, *Portfolio and Asset Management Handbook: Residential Communities Initiative Privatized Army Lodging*, ver. 5.0 (September 2014). This handbook was revised in December 2019. The revised handbook noted that all Major Decisions required final approval from the Deputy Assistant Secretary of the Army (Installations, Housing and Partnerships).

Installations, Housing and Partnerships, as communicated by Army Headquarters. According to Army officials, this action was due to emergency need to enable the Army and Balfour Beatty to respond to what they considered was a life, health, and safety concern. Specifically, according to Army officials, these funds were needed to make repairs that, if not completed quickly, would risk damages to household goods, water intrusion, and mold.

However, the Army's Major Decisions policy in effect at the time of this action in March 2018 did not outline the circumstances that might warrant the verbal approval of Major Decisions, such as those related to life, health, and safety. Therefore, in a draft of this report we provided to DOD in December 2020 for its review and comment, we included a recommendation that the Army update its Major Decisions policy to outline the circumstances that would be appropriate to warrant the verbal approval of Major Decisions. In January 2021, while DOD was reviewing a draft of the sensitive version of this report, the Army updated its Major Decisions policy to allow for verbal approval of Major Decisions in the case of urgent requests for life, health, and safety requirements followed by a written request within 5 business days of the verbal approval.³³

Air Force. The Air Force took funding actions to aid AETC Group I's response to Hurricane Michael. Our sensitive report identified a shortcoming related to one of these actions. Discussion of this shortcoming has been omitted because the information was deemed sensitive by DOD.

³³Assistant Secretary of the Army for Installations, Energy, and Environment Memorandum, *Residential Communities Initiatives (RCI) Major Decision (MD) Policy* (Jan. 25, 2021).

The Military Departments Have Exercised Insufficient Oversight of Privatized Housing Insurance, and OSD Has Not Regularly Monitored Their Actions

We found that the military departments have exercised insufficient oversight of their privatized housing projects' insurance, and OSD has not regularly monitored the military departments' implementation of insurance requirements. Specifically, while the military departments—the Air Force, Army, and Navy—have conducted and documented some reviews of the selected projects' insurance coverage, these reviews have had shortcomings. Further, while OSD has exercised oversight of the Military Housing Privatization Initiative in general, it has not regularly monitored the results of the military departments' insurance reviews or development of interdepartmental cost-sharing agreements. Our sensitive report included a more detailed discussion of our three selected projects' insurance information. Discussion of this information has been omitted because it was deemed sensitive by DOD.

The Air Force Has Conducted and Documented Regular Reviews of Property Insurance Coverage, but Has Not Resolved Issues in a Timely Way

The Air Force conducted and documented annual reviews of insurance coverage, including property insurance, as part of its oversight of AETC Group I during our timeframe—December 2016 to December 2019. The reviews compared the project's property insurance certificates—which identify the policy's key terms—to the insurance requirements in the project's business documents to determine if the terms met the requirements (see fig. 6).

Figure 6: Example Section of an Air Force Annual Insurance Review

Summary of insurance coverage							
Coverage required	Evidenced on certificate	Limits evidenced	Deductible per documents	Deductible per certificate	Policy term	Insurer and rating	Condition met or deficiency
Property insurance – all risk							
Total insurable values (per occurrence)	Yes/No	\$XXX	\$XXX	\$XXX	MM/DD/YY - MM/DD/YY	Insurance Company (rating)	Met/ statement of deficiency
Full replacement cost							
Rent loss - actual loss sustained							
Earthquake							
Flood							
Named windstorm							
60 days notice of cancellation or material change							
10 days notice of cancellation for non-payment							



Source: GAO analysis of Air Force information. | GAO-21-418

Note: This is an example and does not include all of the information in an Air Force annual insurance review, including types of coverage other than property insurance. Further, elements shown in this example may not apply to other privatized housing projects because insurance requirements, which are outlined in each project’s business agreements, vary by project.

However, the Air Force did not resolve potential issues concerning the 2019 to 2020 policy before the renewal of the property insurance policy.³⁴ Thus, the Air Force was unable to gather the information it needed in a

³⁴Our sensitive report discussed these potential issues concerning the property insurance in more detail. Discussion of these potential issues has been omitted because the information is sensitive.

timely way to fully identify and analyze the risks of the policy terms or respond to those risks by, for example, influencing the terms of the new policy. Having this information before the insurance policy was renewed would have improved the Air Force's ability to oversee property insurance coverage and resolve any concerns. Air Force officials told us they plan to establish new business rules in guidance to require engagement with the private developer prior to a project's property insurance policy renewal to ensure that the Air Force has sufficient time to potentially effect change in the policy terms. However, the officials said that they have not yet drafted these new business rules.

Standards for Internal Control in the Federal Government state that management should identify, analyze, and respond to risks related to achieving the defined objectives.³⁵ The Air Force has not established procedures that require resolving with the private developer any discrepancies between insurance coverage and requirements before renewal of the property insurance policy. Without requiring the resolution of identified discrepancies in its annual insurance reviews with the private developer before renewal of the property insurance policy, the Air Force cannot be assured that the projects are complying with requirements and assuming an appropriate balance of risk and cost. Further, timely resolution of discrepancies would help the Air Force ensure that its projects are appropriately insured in the event of a natural disaster, thereby protecting the projects' ability to provide servicemembers and their families with access to quality housing.

Navy Officials Said They Have Conducted Regular Reviews of Property Insurance Coverage, but Have Not Documented the Reviews

Similar to the Air Force, Navy officials responsible for insurance oversight told us they conducted annual insurance reviews of AMCC during our timeframe. However, the officials said they did not document these reviews. The officials provided us with:

- the letters they sent Lendlease requesting the insurance certificates for the policy years in our timeframe, which is the first step in their annual insurance review process; and
- the template tracking spreadsheet containing AMCC's insurance requirements in the project's business agreements that Navy officials said they used to compare the requirements against the insurance certificates provided by Lendlease. Navy officials said they did not find any discrepancies between the insurance certificates and

³⁵[GAO-14-704G](#).

requirements for AMCC. The spreadsheet, however, did not show these comparisons.

The Navy's guidance for insurance reviews requires Navy officials to compare the private developers' insurance certificates with the insurance requirements included in the project business agreements and to annotate these comparisons in a tracking spreadsheet.³⁶ It also requires the officials to request that the private developer explain and correct any issues.

However, we could not confirm whether the reviews occurred. When we asked Navy officials responsible for the insurance reviews for documentation that the requirements in the Navy's guidance had been fulfilled, they told us they do not document the results of the reviews. They noted that they address any issues found during the reviews directly with the private developers. However, documenting the results of the reviews would help the Navy ensure that its projects are appropriately insured in the event of a natural disaster, thereby protecting the projects' ability to provide servicemembers and their families with access to quality housing.

We also could not determine whether the Navy identified, analyzed, or responded to any risks identified in the policy terms before policy renewal because the Navy's guidance does not require that any discrepancies identified in its annual insurance reviews be resolved with the private developer before renewal of the property insurance policy. Standards for Internal Control in the Federal Government state that management should identify, analyze, and respond to risks related to achieving the defined objectives.³⁷ By requiring that any discrepancies identified between insurance coverage and requirements in the project's business agreements be resolved with the private developer before renewal of the property insurance policy, the Navy would be better positioned to potentially effect change in the next year's policy terms and ensure that the projects are complying with requirements and assuming an appropriate balance of risk and cost.

³⁶Navy, *B-25.9.6.16 Insurance Certifications Review* (Feb. 18, 2020). Although this guidance document was updated in 2020, Navy officials said that the insurance certification review process was in place during our review's timeframe.

³⁷[GAO-14-704G](#).

The Army Has Not Regularly Conducted Annual Reviews of Property Insurance Coverage for Fort Carson

The Army has not regularly conducted annual reviews of property insurance coverage, as practiced by the Air Force and Navy. For example, the Army did not conduct a review for Fort Carson, Colorado, comparing the project's property insurance certificates to the insurance requirements in the project's business documents during our timeframe.

The Army cannot resolve insurance issues if it does not identify and analyze the risks of the property insurance coverage. Army privatized housing officials also told us that the Army reviews insurance coverage as required based on changes in the insurance industry or changes due to significant storm damage. The Army's current privatized housing handbook defines an insurance review as an evaluation of a project's entire insurance program, and says the reviews should be completed as required to assist in resolving issues, rather than annually.³⁸ However, estimated damage costs for potential natural disasters, property values, and insurance costs can change the risks to the projects from year to year. Property insurance policies—and their associated coverages—are renewed annually and can reflect these changes in risks to the projects.

Standards for Internal Control in the Federal Government state that management should identify, analyze, and respond to risks related to achieving the defined objectives.³⁹ However, the Army did not complete annual insurance reviews that fully complied with this standard. Without requiring annual insurance reviews that compare coverage to requirements, documenting compliance with each provision, and resolving discrepancies before policy renewal, the Army cannot be assured that the projects are complying with requirements or assuming an appropriate balance of risk and cost. Additionally, without requiring annual reviews, the Army is not as well-positioned to effect change as needed in the next year's policy terms. Conducting these reviews would help the Army ensure that the projects are appropriately insured in the event of a natural disaster, thereby protecting the project's ability to provide servicemembers and their families with access to quality housing.

³⁸Department of the Army, *Portfolio and Asset Management Handbook*, ver. 6.0. The previous version of this guidance, which was issued in September 2014, included the same definition and requirement for insurance reviews.

³⁹[GAO-14-704G](#).

OSD Has Exercised Oversight of Privatized Housing, but Has Not Regularly Monitored the Military Departments' Implementation of Property Insurance Requirements

OSD has exercised oversight of privatized housing projects affected by natural disasters but has not regularly monitored the military departments' implementation of property insurance requirements contained in the projects' business documents. For example, OSD has monitored risks to privatized housing projects' long-term financial viability by collecting data for an annual report to Congress.

However, as of November 2020, OSD had not regularly monitored the military departments' implementation of the property insurance requirements in the projects' business agreements. Specifically, OSD privatized housing officials told us that OSD had not reviewed the results of the military departments' insurance reviews. OSD privatized housing officials stated that insurance oversight is generally the responsibility of the military departments because they are responsible for negotiating, executing, and monitoring the project's compliance with business agreements, to include insurance coverage requirements.

DOD's housing management policy states that the Assistant Secretary of Defense for Sustainment should oversee military department implementation of the housing privatization authority, which includes entering into business agreements for projects.⁴⁰ OSD annually collects detailed information from the military departments regarding the performance of their privatized housing projects, including financial and operational data. However, OSD has been limited in its ability to monitor the military departments' implementation of property insurance requirements. Specifically, as of November 2020, OSD privatized housing officials told us that OSD did not require the military departments to regularly report on their implementation of property insurance requirements, to include the results of insurance reviews and interdepartmental cost-sharing agreements. Therefore, in the draft report we provided to DOD in December 2020 for review and comment, we included a recommendation that OSD require the military departments to regularly report on their implementation of property insurance requirements. In January 2021, while DOD was reviewing a draft of the sensitive version of this report, OSD issued a new approval and notifications policy memorandum that requires quarterly programmatic reviews with each military department on each department's respective

⁴⁰DOD Manual 4165.63, *DOD Housing Management*.

privatized housing portfolios.⁴¹ Further, the new policy specifically identifies insurance reviews as a topic area to be addressed.

Conclusions

DOD's oversight of the financial viability, funding structures, and property insurance coverage of privatized housing projects is critical to ensure that the privatized housing projects are effectively positioned to respond to natural disasters and to provide servicemembers with access to quality housing. Recent natural disasters have demonstrated that such events can create significant financial challenges for privatized housing projects.

The military departments have exercised insufficient oversight of their privatized housing projects' insurance. While the military departments have conducted reviews of selected projects' insurance coverage, our review identified procedures that should be improved.

Recommendations for Executive Action

In the sensitive version of this report, we made a total of 7 recommendations to DOD. The following 3 recommendations—one to the Secretary of the Air Force, one to the Secretary of the Navy, and one to the Secretary of the Army—were determined by DOD to be publicly releasable if summarized to remove sensitive content, as shown below.

The Secretary of the Air Force should ensure the Assistant Secretary of the Air Force for Installations, Environment, and Energy establishes procedures to improve the Air Force's annual insurance reviews for privatized housing projects. (Recommendation 1)

The Secretary of the Navy should ensure the Assistant Secretary of the Navy for Energy, Installations and Environment documents the Navy's annual insurance reviews for privatized housing projects and establishes procedures to improve the Navy's annual insurance reviews for privatized housing projects. (Recommendation 2)

The Secretary of the Army should ensure the Assistant Secretary of the Army for Installations, Energy, and Environment establishes procedures to improve the Army's annual insurance reviews for privatized housing projects. (Recommendation 3)

⁴¹Assistant Secretary of Defense for Sustainment Memorandum, *Military Housing Privatization Initiative—Approval and Notifications Policy* (Jan. 15, 2021).

Agency Comments

We provided a draft of our sensitive report to DOD for review and comment. DOD's comment letter included sensitive information, so it is not included in this report. In commenting on our sensitive report, DOD concurred with our 7 recommendations.⁴² DOD also provided technical comments on the sensitive report, which we incorporated as appropriate.

In the draft sensitive report we provided to DOD for comment in December 2020, we included an additional recommendation for the Army to update its Major Decisions policy. While DOD was reviewing the draft of the sensitive report, the Army updated its Major Decisions policy in January 2021 to allow verbal approval of urgent Major Decisions requests for life, health, and safety requirements, followed by a written request within 5 business days. Because the Army's updated policy addressed our draft recommendation, we withdrew that recommendation from our final sensitive report.

In the draft sensitive report, we also included a recommendation for OSD to require the military departments to regularly report on their implementation of property insurance requirements, to include the results of insurance reviews and interdepartmental cost-sharing agreements. In its comments, DOD concurred with the draft recommendation, and while DOD was reviewing the draft sensitive report, OSD issued a new policy, effective January 2021, that requires the military departments to report on their implementation of property insurance requirements as part of quarterly programmatic reviews. Because DOD's policy addressed our draft recommendation, we withdrew that recommendation from our final sensitive report.

We are sending copies of this report to the appropriate congressional committees; the Secretary of Defense; the Acting Secretaries of the Army, the Navy, and the Air Force; and the Acting Director of the Office of Management and Budget. In addition, the report is available at no charge on the GAO website at <https://www.gao.gov>.

⁴²The sensitive version of this report included a total of 7 recommendations. Four of those recommendations have been omitted in this report because the information is deemed sensitive by DOD.

If you or your staff have any questions about this report, please contact me at (202) 512-2775 or FieldE1@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix I.

A handwritten signature in black ink, appearing to read "Elizabeth A. Field". The signature is fluid and cursive, with the first name being the most prominent.

Elizabeth A. Field
Director, Defense Capabilities and Management

Appendix I: GAO Contact and Staff Acknowledgments

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In addition to the contact above, the following staff made key contributions in this report: Margaret Best (Assistant Director), Matthew Young (Analyst in Charge), Aditi Archer, Bonnie Binggeli, Vincent Buquicchio, Colin Chambers, Lijia Guo, David Jones, Clarice Ransom, Garrett Riba, Monica Savoy, Joseph Thompson, John Van Schaik, and Pat Ward.

Related GAO Products

Military Housing Privatization: DOD Should Improve Oversight of Property Insurance and Natural Disaster Recovery. [GAO-21-184SU](#). Washington, D.C.: February 18, 2021.

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