



The Commonwealth of Massachusetts
Office of the Inspector General

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Mr. Thomas R. Gleason
Executive Director, MassHousing
One Beacon Street
Boston, MA 02108-3110

Dear Director Gleason:

Thank you for the opportunity to comment on the draft of MassHousing's 40B Cost Certification Instructions (dated 10/6/06). My initial comments are summarized below. Prior to adoption of these instructions, I would like to meet with you in order to discuss in more detail recommended improvements to the cost certification process.

As a general statement the cost certification should be based on actual costs. The cost certification audits/reviews should be geared towards validating actual expenditures made by the developers. The validation process should examine actual invoices and associated check disbursements. Unsupported related party overhead and profit allowances should not be allowed. Comparison to RS Means Construction Data is a valuable analytical step; however, this should never be used as a substitute for actual project expenditures. Municipalities need to be incorporated as parties in the cost certification process. The draft instructions keep the municipalities at a distance. The municipalities have strong vested interests in ensuring a fair, accurate and timely accounting of project profits. A municipality's interests in a development continue far into the future whereas the interests of the developer and the project administrator terminate relatively soon after a project is built-out and construction loans repaid. These local interests need to be recognized and supported. A municipality should be encouraged and enabled to become the primary focus in the selection of the independent certified public accounting firm that will perform the final cost certification audit/review. Municipalities should also be encouraged to assume the role of monitoring agent. As an alternative approach, an independent oversight agency could be established to administer this critical certification role.

Savings in both time and expense can be gained by focusing final cost certification efforts through the municipalities. Rather than having three (3) levels of review (developer's CPA audit, project administrator's review by a separate CPA and municipality's review) as reflected in the draft instructions, efficiencies can be achieved by having one independent audit commissioned by the municipality or independent oversight agency, adhering to standard but rigorous limited dividend audit protocols.

Recommended protocols are enclosed as a separate document for your review.

Our experience has shown that the required developer cost certifications are generally submitted on an untimely basis (if at all). In order to ensure a timely submission of these essential financial statements, penalties should be assessed against delinquent developers. These penalties should accrue over the delinquency period. In addition if it is later determined that excess profits were generated by the development then reasonable interest on the excess profits should also accrue over the delinquency period. These penalties and associated interest payments should not be allowable project expenses. Any requests by the developer for an extension of the submission deadline should be approved by the municipality along with the project administrator.

In order to help guarantee project completion according to agreed upon plans and also to protect the municipality's interest in potential excess profits, adequate bonds and/or other forms of security should be provided by the developers as part of the comprehensive permit approval process. These arrangements should clearly be articulated in the comprehensive permits and regulatory agreements. The municipalities should be empowered to establish and enforce these protections.

The boilerplate regulatory agreements authored by MassHousing should be updated in order to reflect the oversight roles and responsibilities of the municipalities in the determination and enforcement of the limited dividend requirement of these housing developments within their local jurisdictions. A municipality and the local citizens should never be denied their right to seek legal remedy for any fraud or abuse perpetrated by an unscrupulous developer. The cost certification instructions should clearly articulate the civil and criminal penalties which will be sought against a developer who provides misleading or false cost certifications.

Land valuation is one of the most critical cost elements and probably one of the most problematic. As a general rule land should be valued at actual cost with some reasonable adjustments for carrying costs. The land value should never exceed the as-is fair market value without the benefit of the comprehensive permit. Appraisal standards and methodologies need to be formulated. Real estate tax assessments should be used as a comparative benchmark for appraised land values. The land valuation should be reviewed and agreed to by all parties including the municipality up front prior to approval of the comprehensive permit. Also as a general rule land valuation, especially between related parties, should be reflective of the appropriate tax basis.

Since related party transactions are entered into without the benefit of a competitive bidding process and since higher development costs provide both an opportunity and an incentive for higher profits for the developer at the expense of the municipality, it is imperative that these transactions are transparent. In our investigation we have observed that virtually no excess profit payments have been

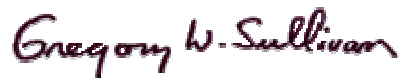
made to the municipalities. The generous related party guidelines proposed through the current draft virtually guarantees that few if any profits will flow to municipalities.

The equity rules for rental projects adversely affect local affordable housing initiatives. By allowing a project owner to reflect appreciated market values as opposed to actual investment costs in determining their annual dividends again basically ensures that municipalities will never share in any "excess" profits which in turn will adversely impact local affordable housing initiatives.

Since continued affordable housing development is of such great importance to the commonwealth, help and guidance from the legislature is necessary. The legislature should be given an opportunity to review these sensitive provisions and determine whether any changes should be memorialized by statute. This Office is anxious to work with you, in order to improve the Chapter 40B cost oversight process and to help sponsor the appropriate legislation.

If you have any questions or concerns, please do not hesitate to call me.

Sincerely,

A handwritten signature in dark ink that reads "Gregory W. Sullivan". The signature is written in a cursive, slightly slanted style.

Gregory W. Sullivan
Inspector General

Cc: Jane Wallis Gumble