



The Commonwealth of Massachusetts
Office of the Inspector General

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May 26, 2006

Mr. Peter Ashton
Chairman, Board of Selectmen
Town of Acton
472 Main Street
Acton, MA 01720

Mr. Don P. Johnson
Town Manager
Town Of Acton
472 Main Street
Acton, MA 01720

Subject: Developer Profits – Crossroads Development, LLC

Dear Chairman Ashton and Manager Johnson;

In July, 2005 the Office of the Inspector General provided the town of Acton with preliminary cost recovery findings (letter attached) related to the housing development implemented under M.G.L. c. 40B by Crossroads Development, LLC (Crossroads) at 244 Main Street. Since then this Office has initiated a detailed and comprehensive review of 40B projects primarily focused on the determination and reporting of the associated developer profits. The Crossroads project was one of several projects selected for this detailed review. Highlighted below are our findings based on this review. We hope this information is useful to the town of Acton in arriving at an appropriate financial settlement with the developer. We plan to use the results of all the individual development audits (including Crossroads) in order to identify and implement improvements to the 40B process.

In order to facilitate our review of 40B developer profits, this Office has contracted with the certified public accounting firm of Melanson Heath & Company, PC (Melanson) to perform the necessary agreed upon audit procedures. A copy of the Melanson report is enclosed for your review and use. A draft of this report was reviewed with Crossroads through their attorney, Mr. Brian Hurley, Esq. of Rackemann, Sawyer, & Brewster. Also, enclosed for your review is all correspondence between this Office and Attorney Hurley throughout this process.

The Crossroads development was built under the New England Fund (NEF) subsidy program which allowed a developer profit of up to 20% of the total development costs of the project. The cost certification provided by the developer to the town reflected total development costs of \$2,702,069 and an associated profit of \$525,431 or 19.45% of total development costs. The developer did not make any excess profit payment to the town since the reported profit was less than the designated 20% allowed under the NEF subsidy program.

Our investigation has highlighted a significantly different profit scenario for Crossroads. We found that the cost certification provided by the developer understated sales by \$50,000 and overstated expenses by approximately \$600,000. The net effect of these proposed adjustments is a revised profit percentage of 57% which in turn results in an excess profit payable to the town of Acton of approximately \$763,000. Based on the regulatory agreement these monies can be used by the town to promote additional affordable housing opportunities.

The \$50,000 sales adjustment relates to the sale of housing unit 4 to a related party and the subsequent resale of the property to a third party at a profit. As was communicated back in our April 2005 letter to the town, unit 4 at 248 Main Street was sold in December 2004 to Stow Street Realty, Inc. The principals of Stow Street Realty, Inc. are James Fenton and Michael Jeanson who are also the developers of Crossroads. The other 8 market units sold for an average of \$312,000 and the sales price range for these units was between \$299,000 and \$335,000. As was reflected in the cost certification unit 4 was sold to Stow Street Realty, Inc for \$250,000. Less than one month after the cost certification was submitted to the town, Stow Street Realty, Inc resold the unit to a third party for \$300,000. In our opinion the arms length transaction of \$300,000 should be reflected in the profit calculation and not the related party transaction amount of \$250,000.

As was previously noted, we found that the cost certification overstated development costs by approximately \$600,000. The largest proposed adjustment (\$396,334) relates to a related party transaction for site development work. Although requested on multiple occasions, the developer has not provided any back-up expense invoices for this billing. It should be noted that separate payments were also made to other vendors for paving, landscaping materials and foundation installation. In comparing Crossroads to another similar development in scope but one which used a third party contractor to do the site development work we noted these third party site development costs to be in the neighborhood of \$40,000 or an order of magnitude cost difference from the related party costs claimed by Crossroads. Other proposed related party adjustments include \$43,373 for administration/construction management costs and \$24,975 for real estate sales commission costs.

A construction management fee of \$84,600 was paid to Distinctive Acton Homes, a related party to the developer. The amount was determined by taking 3% of the expected sales revenue of \$2,820,000. This fee was not disclosed by the developer in pro forma financial information submitted by the developer in the comprehensive permit application. In our opinion, a strong case could be made to disallow the entire \$84,600 construction management fee since this was not previously disclosed to the town and since the regulatory agreement specifically states that development costs for calculating the 20% profit are exclusive of development fees. The proposed adjustment of \$43,373 reduces the construction management fee to 2% of construction costs or \$41,227 which is more in line with recent Department of Housing and Community Development (DHCD) guidance.

Another related party, Colonial Homes Real Estate, Inc., was the broker for the market units sold. Colonial Homes Real Estate, Inc. was paid a 6% commission rate on the sale of eight market rate units. Using the guidance recently published by DHCD that if there is an identity of interest between the development entity and the brokerage agency, the fee on the sale of the market units should not exceed 5%. Adjusting this related party commission rate to 5%, results in a \$24,975 reduction in allowable development costs which should be used in the developer profit calculation. Our preliminary work with other projects where the real estate broker is not related to the developer indicates commission rates even lower than the 5% related party rate advocated in the recent DHCD guidelines.

Other significant proposed cost adjustments include a refund of \$56,733 which was received by the developer from the town of Acton for excess sewer connection fees paid. This refund was received by the developer after the cost certification was submitted and therefore was not considered in either the sewer connection costs or the profit calculations. Approximately \$35,000 of costs were adjusted down since the developer was unable to provide adequate support backup. Insurance premiums for multiple entities totaling \$46,251 were charged to the Crossroads project. The developer was not able to provide the backup showing the portion related to Crossroads directly, and therefore these costs have also been excluded from the allowable development costs. It should be noted that the pro forma financials only reflected a \$15,000 insurance related cost. We are also of the opinion that since a 2% management fee was allowed, this would cover these types of expenses.

Proposed cost adjustments also include among other things a \$3,251 charge for carpeting which was not installed in the project, an adjustment of \$9,974 for early payment discounts and credit memos received by the developer on payments but not reflected in costs charged to jobs in the general ledger; and, a duplicate invoice charge of \$7,729.

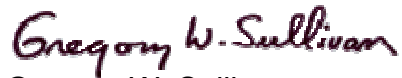
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We would be happy to arrange a meeting with you in order to discuss these findings in more detail. If you have any questions or concerns, or if we can be of other assistance, please do not hesitate to call me.

Sincerely,

A handwritten signature in dark ink that reads "Gregory W. Sullivan". The signature is written in a cursive style with a large initial 'G'.

Gregory W. Sullivan
Inspector General

Enclosures

Cc: Mr. Dan Hill Esq.

Mr. Brian Hurley, Esq.