The Commonwealth of Massachusetts
Office of the Inspector General

GREGORY W. SULLIVAN
INSPECTOR GENERAL

JOHN W. McCORMACK
STATE OFFICE BUILDING
ONE ASHBURTON PLACE
ROOM 1311
BOSTON, MA 02108
TEL: (617) 727-9140
FAX: (617) 723-2334

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Senator Marc R. Pacheco, Chair
Senate Committee on Post Audit and Oversight
State House, Room 312B
Boston, MA 02133

Dear Chairman Pacheco,

I thank you for allowing me the opportunity to address the very important issue of in Chapter 40B. As you know, my Office has been reviewing this process for some time. That review has uncovered numerous abuses developers have used to conceal excess profits. My Office has highlighted those abuses through reports, public testimony and meetings with various stakeholders, including the Department of Housing and Community Development (DHCD

Though DHCD has promulgated new regulations within the last year to address some of these issues, I do not believe that these changes have corrected the underlying systemic inadequacies of the program. One issue in particular that I would like to address is the weakening of municipal standing under recent changes.

Municipalities are parties of interest in the project financials and as such should be treated accordingly. However, the recent changes diminish and marginalize the role of municipalities and put their financial interests at risk. The new regulations and guidelines impair the ability of municipalities to gain access to project financial information. Municipalities have a fiduciary responsibility in assuring a developer's compliance with the cost certification process. A municipality's right to request, review and challenge the pro forma or other financial statements including the cost certification for a project is significantly limited. A municipality, as a party of interest, not only has the right but also the duty to review pro forma or other financial statements as part of the site/project eligibility process and as part of the comprehensive permit process. At the completion of the project the municipality should be able to examine in detail the cost certification and the developer's support for the actual costs. Municipalities are allowed the very limited time of 30 days to evaluate the cost certification. As the

administration has publicly stated local governments face very tight fiscal restraints. It will be difficult for them to divert staff from other duties to review the cost certification in such a limited timeframe.

In practice, municipalities have traditionally been the beneficiaries of any excess development profits. The new regulations place this custom at risk by providing that "Any funds in excess of applicable limitations on profits and distributions shall be paid over to the Subsidizing Agency or the municipality, as determined solely by the Subsidizing Agency's program requirements and the terms of a regulatory agreement, or similar agreement, to be entered into between the Subsidizing Agency and the Developer." Though the guidelines state that excess funds must go to the municipality, guidelines do not carry the same weight as regulations.

The regulations should require that a subsidizing agency, prior to issuing a project eligibility letter, ensure through detailed review and analysis of the project pro forma and any necessary supporting details that there is reasonable likelihood that the project's net profit will not exceed 20% of allowable development costs. The regulations should also require that any transfer of comprehensive permit or project ownership will trigger the requirement for a full cost certification and that these cost certifications be through a detailed audit following the more rigorous Government Auditing Standards as opposed to the current position of an examination.

The regulations empower the Subsidizing Agencies to be "solely responsible for the monitoring and enforcement" of profit limitations. Since Subsidizing Agencies like MassHousing are not subject to administrative law under Chapter 30A, municipalities are placed in a compromised position due to their lack of standing in an appeals process. These banks or subsidizing agencies have an inherent bias. The business relationship between the bank and the developer stands in the way of effective, meaningful, and independent or arms-length cost monitoring efforts. Rather than taking decisive measures to eradicate the fraud and abuse in the system, the reaction from the banks and DHCD has been to put up barriers to external oversight. It is unwise to expect a bank that has a financial business relationship with a developer to also function in the "unnatural" role of financial oversight agent representing the potential interests of a municipality. This creates conflict between the bank and the bank's customer, the developer.

The regulations should provide that appraisers and CPAs should be pre-qualified by DHCD. The appraiser used to determine the land acquisition value should be chosen by the municipality from the pre-qualified list of appraisers created by DHCD. Similarly the certified public accountant performing the cost certification validation should be chosen by the municipality from the pre-qualified list of CPAs created and maintained by DHCD. At the very least the appraisers and CPAs should be randomly assigned by DHCD. Related-party transactions should be disclosed at the beginning of the process and full documentation should be required to justify the costs incurred. The regulations should provide that all related party transactions reflect bona fide generally accepted accounting and taxable transactions between the related entities and should reflect

actual costs incurred.

The regulations should address definitions for the various allowable development costs and for development revenue. Reasonable return should also be specifically articulated in the regulations, not in guidelines. The regulations do not fully address the meaning of the term “uneconomic” in the context of the construction of affordable housing. Decision making is hampered without a clear “uneconomic” standard. This shortcoming is also addressed in the recent (June 2008) Supreme Judicial Court decision (Board of Appeals of Woburn vs. Housing Appeals Committee). DHCD has chosen to address this issue in their guidelines, not through regulations, by stating that any reduction in the size of a project of more than five percent would create a presumption that it would render the project “uneconomic”, and has placed the burden of proof on the municipality. Major policy changes such as this coupled with changes in profit limits should be made with due process in a transparent framework.

In addition to the cost certification report, all Chapter 40B applications (such as project eligibility/site approval and comprehensive permit, etc.) should be submitted under pains and penalties of perjury. Neither the regulations nor guidelines issued by DHCD address this issue. Requiring submissions under pains and penalties of perjury are commonly applied throughout the commonwealth and provide a simple and cost effective means of deterrence.

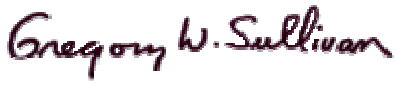
The land value appraisal should be based on the “as-is” value of the land. The previously established land valuation policy clearly articulated that the value of the land should relate directly to the “as-is” value of the site under current zoning and should not be artificially inflated as a result of the extra value provided by a comprehensive permit or a non-arm’s length conveyance between related parties. The recent guideline/regulatory changes have added ambiguity to the valuation policy by allowing the land valuation to “take into account the probability of obtaining a variance, special permit or other zoning relief” versus the established “as-is” under current zoning direction. This change together with the diminished role of the municipality in the financial review of these projects provides increased opportunities for fraud and abuse.

The guidelines now provide that a deposit be made in escrow by the developer in order to ensure that a cost certification is completed. However, the amount of the deposit is nominal and there is no provision prohibiting the developer from involvement in other projects if a cost certification is not completed. Regulations should address sanctions against developers who fail to submit a cost certification on a timely basis. Penalties and interest should accrue. The regulations should require developers to post adequate forms of guaranty that will help ensure timely project completion and cost certification compliance.

In closing, I believe there is still a long way to go before the financial interests of the public are protected by the cost certification process under Chapter 40B. The changes recently made through regulations and guidelines issued by DHCD have actually increased the opportunities for fraud and abuse in the development of

affordable housing. My Office will continue to advocate for a stronger cost certification process until such time as adequate protections are in place.

Sincerely,



Gregory W. Sullivan
Inspector General