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

December 21, 2009

Tina Brooks, Undersecretary
Department of Housing and Community Development
100 Cambridge Street, Suite 300
Boston, MA 02114

Dear Undersecretary Brooks,

The proposed regulations being heard by the Department of Housing and Community Development (DHCD) need to be strengthened in order to provide adequate fraud protections. As I have conveyed to you over the past few years, my Office has uncovered numerous abuses developers have used to conceal excess profits. The proposed regulations do not correct the underlying systemic inadequacies of the program. In many respects these regulations legalize the excess profit-taking my Office has previously identified and strips municipalities of the rights necessary to protect their interest.

The regulations define the meaning of the term “uneconomic” in the context of the construction of affordable housing 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. This definition is nondescript and leaves it up to the subsidizing agencies to really define. It also shifts an undue burden on the municipality at a time of fiscal crisis and further strips the municipality of any ability to provide a degree of fiscal oversight over Chapter 40B projects. Density should be set, as formerly established by Mass Housing, in the regulations as four times the density of the underlying zoning, or up to eight units per acre, whichever is greater. The density guidance currently in effect in the Chapter 40B guidelines allows for an exorbitant amount of units to be built per acre. It is my understanding that DHCD intends to strike the density guidelines, which will have the effect of eliminating all limitations on density except as provided in 760 CMR 56.03(6). By not addressing density in these regulations DHCD is leaving the door open for almost unlimited scope and dollar amount of profit. “Reasonable return” should also be specifically articulated in the regulations, not in guidelines, and should not just provide

for a percentage of development costs, but also should take into account the scope of the project.

Municipalities are parties of interest in the project financials and as such should be treated accordingly. I would think DHCD would welcome help in identifying potential fraud issues in individual projects. However, the regulations diminish and marginalize the role of municipalities and put their financial interests at risk. The regulations impair the ability of municipalities to gain access to project financial information. 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.

In practice, municipalities have traditionally been the beneficiaries of any excess development profits. The 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 within allowable density requirements. 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 are not subject to administrative law under Chapter 30A, municipalities are effectively stripped of their rights as parties to the matter. These regulations continue to put the banks and subsidizing agencies in an inherently conflictual role serving as a partner of the developer while supposedly acting as guardian of municipal interests. The business relationship between the bank and the developer stands in the way of effective, meaningful, and independent protection against excess profiteering.

Appraisers and CPAs should be pre-qualified by DHCD under the regulations. 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. 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.

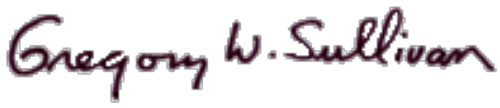
Similarly the certified public accountant performing the cost certification validation should be chosen by the municipality from the pre-qualified list of CPAs created and maintained by DHCD. Related-party transactions should be disclosed at the beginning of the process and full documentation should 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.

In addition to the cost certification report, all Chapter 40B documents (such as project eligibility/site approval applications, pro formas, land valuations, and comprehensive permit, etc.) should be submitted under pains and penalties of perjury. Though the regulations require an acknowledgement that a developer will comply with the cost examination requirements, stronger protections are necessary.

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.

I believe DHCD has missed an opportunity to significantly strengthen the cost certification process for comprehensive permit projects. These proposed regulations must provide safeguards to deter fraud and abuse from occurring 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