



The Commonwealth of Massachusetts
Office of the Inspector General

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December 6, 2006

Mr. Aaron Gornstein
Executive Director, CHAPA
18 Tremont Street – Suite 401
Boston, MA 02108

Dear Director Gornstein:

Your letter of November, 20, 2006 to the town of Wareham (Cedar Farm Estates) and your letter of November 27, 2006 to the city of Leominster (Lancaster Estates) regarding this Office's review of the respective Chapter 40B housing developments are troubling and raise several concerns. You correctly point out in your communications that this Office's findings agree with CHAPA's findings in that these developers did not exceed the 20% limited dividend profit. However your letters do not accurately represent the audit procedures and the land valuation methodology used by this Office in conducting our reviews. I hope to clarify these issues so we all have the same understanding as we move forward with the remaining audits. In addressing these concerns I have tried to follow your sequencing.

Comments on the IG's Procedures for Reviewing 40B Projects

In your letters you correctly state that both of these developers applied for a permit *prior* to the adoption of the February 2003 state guidelines governing the New England Fund (NEF). However, as I am sure you are aware as the monitoring agent, the Cedar Farm Estates development in Wareham was approved *after adoption* of the February 2003 NEF guidelines. As such these NEF guidelines are applicable to this Wareham project. The CHAPA guidelines and Director Gleason of MassHousing have reinforced this applicability.

Your comments that this Office used the Massachusetts Housing Partnership's (MHP) November 2005 guidelines and retroactively applied these rules to both of these developments is misleading as it is only partially true. These MHP guidelines were used by this Office in evaluating the reasonableness of the brokerage commissions and lottery expenses since these guidelines provided more direction for assessing these costs than what was available through the monitoring procedures used by CHAPA in

performing the cost certifications for these two developments. It should be noted that our audits found no issues relative to these brokerage commissions and lottery expenses. With respect to the substantive issues of land valuation and related party overhead/profit this Office used the existing CHAPA guidelines as the basis for our audits. These are the same guidelines used by CHAPA in conducting its own cost certification reviews of these two developments.

Specific to the land valuation audit procedures, our audits, similar to the CHAPA reviews, focused on the established CHAPA guideline which as stated was to determine that the land value *“reflect the value of the site under its highest and best use without a comprehensive permit; unless stated otherwise in the comprehensive permit or regulatory agreement”*. This Office also used the guideline followed by CHAPA in assessing the reasonableness of related party costs which are accepted as a total of *“14% for general contractor overhead, general conditions, and profit”*. These guidelines served as the basis for any proposed adjustments identified through our detailed audits.

Treatment of Land Value

In your communications to the town of Wareham and to the city of Leominster you indicate that it is your understanding that with respect to determining allowable acquisition costs *“the IG’s Office has decided to use the municipality’s assessed value of the land prior to the issuance of the comprehensive permit”*. Contrary to your statements, this Office is not advocating the retroactive application of new standards, such as the use of tax assessments as a proxy for allowable land acquisition costs. In those cases where an independent appraisal was not available, we used the tax assessments as a tool in validating that the developer claimed land acquisition costs is reflective of the value of the site under its highest and best use without a comprehensive permit. Tax assessments provide an independent benchmark value to be reviewed and analyzed in these value determinations. There will be times when tax assessment values will be greater than fair market value as well as instances where the opposite is true.

There were no independent appraisals submitted for either the Cedar Farm Estates or the Lancaster Estates developments as part of the cost certification process. In situations where an appraisal is not available, we understand that CHAPA’s procedures call for *“...excluding all land value to determine if this causes the project to exceed the 20% profit limitation. If so, then CHAPA’s consultant undertakes further scrutiny of the land value.”*

Similar to the CHAPA commissioned reviews, this Office first looked to determine whether an independent land appraisal reflecting fair market value under existing zoning without a comprehensive permit in place was provided by the developer as part of the cost certification process. In the absence of such independent appraisals, rather than using a zero value, this Office considered other independent sources including the town’s tax assessment records and any recent land purchase transactions, in order to

make a reasonable determination of the value of the site under its highest and best use without a comprehensive permit in place. In the audit reports issued to Wareham and Leominster, this Office articulated in detail the methodology followed in this determination of values. We believe that these determined values are more equitable than either the zero value used by CHAPA in its analyses or the higher “market rates” used by the developers in their financial statements. We understand that CHAPA would have scrutinized these values in finer detail if the project analyses (after excluding land value) had reflected profits in excess of the 20% limitation. It would be interesting to see if additional scrutiny of the land valuation by CHAPA would have led CHAPA to land value determinations similar to those arrived at by this Office.

The land valuation issue is one of the most critical elements of the cost certification process. It is imperative that the cost certification process provides a validation that the allowable land acquisition costs do not exceed the fair market value under existing zoning without the benefit of the comprehensive permit. Even transactions between unrelated parties, which can be characterized as “arms length”, do not necessarily conform to the fair market valuation guidelines under existing zoning. Purchase and sale agreements made contingent upon density bonuses are obvious red flags as are those situations where a parcel is sold to a third party developer after a comprehensive permit has already been issued. Each cost certification audit should provide for an independent assessment on this important land valuation issue.

This Office acknowledges the concerns you have shared regarding the shortcomings of various state agencies, especially the Department of Housing and Community Development for their untimely response to providing CHAPA with detailed guidance and standards for conducting cost certification reviews and for providing specific guidance on the acceptability of excess land charges as allowable costs for older NEF projects. However, to reinforce the point stated earlier, all the substantive findings related to both the Cedar Farm Estates and the Lancaster Estates audits were measured against the then existing CHAPA monitoring guidelines.

In your letters you reference that many regulatory agreements governing NEF-financed projects during the time period of 2000-2003 require the use of “post permit” land value. In our sample of projects, to date we have not found any that fall into this grouping. If a municipality has freely and knowingly entered into such an understanding as a signatory to the regulatory agreements this Office would not take exception to this methodology. It would be helpful if you could provide a listing to this Office of those agreements which fall into this category.

You also mentioned in your letter that several Housing Appeals Committee decisions have allowed full market value to be considered. Please provide this Office with a listing of those projects so a detailed review can be performed. This practice is extremely troubling especially since related Chapter 40B guidelines provide that the economic benefits of a comprehensive permit should accrue as profit to the development. Conversely, these economic benefits should not be reflected as allowable

Aaron Gornstein – CHAPA

December 6, 2006

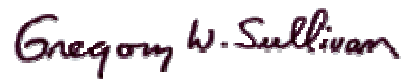
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development costs which would reduce reported project profits. Allowing this full market value consideration in HAC decisions could result in the transfer of profits from a municipality's affordable trust fund to a developer's personal bank account.

I hope this clarifies the audit approach and the treatment of land value used by this Office in conducting its cost certification audits of these two Chapter 40B developments.

Please feel free to call me if you have any questions or concerns.

Sincerely,

A handwritten signature in dark ink that reads "Gregory W. Sullivan". The signature is written in a cursive style with a prominent "G" and "S".

Gregory W. Sullivan
Inspector General

Cc: Thomas Gleason, Executive Director, MassHousing
Jane Wallis Gumble, Director, DHCD
Matthew Dacey, Champion Builders
R. Renee Fernandes-Abbott, Chairwoman, Wareham Board of Selectmen
Michael Hartman, Wareham Town Administrator
Kenneth R. Ferreira, Wareham Zoning Board of Appeals
Dean Mazzarella, Mayor, City of Leominster
Eric Sullender, Bovenzi/Lancaster Estates
James Moriarty, Bovenzi/Lancaster Estates
Steven Decarolis, Chairman, Leominster Zoning Board of Appeals
Gene Capoccia, Executive Director, Leominster Housing Authority