



The Commonwealth of Massachusetts
Office of the Inspector General

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November 3, 2006

Ms. R. Renee Fernandes-Abbott
Chairman, Board of Selectmen
Town of Wareham
Memorial Town Hall
Wareham, MA 02571

Mr. Michael Hartman
Town Administrator
Town of Wareham
Memorial Town Hall/Administration
Wareham, MA 02571

Subject: Chapter 40B Developer Profits – Cedar Farms Estates Realty Trust

Dear Chairman Fernandes-Abbott and Administrator Hartman:

In order to determine the effectiveness of the Chapter 40B cost certification oversight process and to ensure the reasonableness and accuracy of reported developer profits the Office of the Inspector General selected a sample of 10 completed home ownership developments initiated under provisions of the Chapter 40B legislation for detailed review and analysis. Included in this sample was the Cedar Farm Estates project at Swifts Beach Road in Wareham which was developed by Cedar Farm Estates Realty Trust. Highlighted below are our findings based on this review of the Cedar Farm Estates development. We hope this information is useful to the town of Wareham in planning and implementing future 40B housing developments. We plan to use the results of this audit along with the results from the other nine audits in order to identify opportunities for improving the Chapter 40B oversight process which in turn should help affordable housing initiatives throughout the commonwealth.

This Office contracted with the certified public accounting firm of Melanson Heath & Company, PC (Melanson) to perform the necessary agreed upon audit procedures. These detailed audit procedures were focused on verifying the income and expenses reported by the developers through the financial cost certifications submitted by them to the monitoring agents. The expenses claimed by the developers were reviewed by Melanson for conformity to guidelines prescribed by the Citizens' Housing and Planning Association (CHAPA), the monitoring agent for the Cedar Farm Estates project. Other guidelines from applicable subsidy programs and state agencies which help finance affordable housing developments were also consulted. A copy of the Melanson report

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for the Cedar Farm Estates audit is enclosed for your review and use. A copy of this audit report was already previously provided to the developer (Matthew J. Dacey). On October 20, 2006, Mr. Dacey provided his comments on the report. This correspondence is also enclosed for your reference.

In May 2002, the Massachusetts Housing Finance Agency (MassHousing) issued a Project Eligibility Letter (or Site Approval) under the Housing Starts Program for the Cedar Farm Estates Chapter 40B housing development. The Zoning Board of Appeals for the town of Wareham granted approval for the development in February 2003 and by mid April 2004 all six (6) housing units were built and sold by the developer. The certified public accounting firm of Wallace, Savage & Davis, P.C. performed a review (not an audit) of the project's financial statements on behalf of the developer. The accountant's report was dated in March 2005. This financial report was submitted by the developer to CHAPA, the monitoring agent. CHAPA completed the cost certification and submitted its report to the town in August 2005. The financial statements provided by the developer to CHAPA reflected total development costs of \$1,283,955 and an associated profit of \$16,044 or 1.2% of total development costs. The CHAPA cost certification proposed adjustments for both the land acquisition cost and excess general contractor profits. These proposed adjustments brought the profit percentage up to 18.34% of the total development costs. Since this adjusted profit percentage was still below the 20% profit limit, it was determined that no excess profits were due or payable to the town from the developer.

Our investigation corroborated these findings and also identified some other issues. The Melanson audit report identified adjustments which reduced project expenses and therefore increased profits by a total of \$173,991. The effect of these adjustments is to increase the profit percentage to 17.12% from the developer reported 1.25%. These adjusted profits are again still below the 20% profit limit and therefore no excess profits are available for distribution to the town.

As was highlighted in both the CHAPA cost certification and the Melanson audit report there was no independent appraisal available for the land prior to the issuance of the comprehensive permit. The Melanson report reflects an adjustment of \$21,810 to the land acquisition cost in order to bring the cost down to \$63,190 from the \$85,000 claimed on the cost certification. The adjusted amount represents the arms length purchase price of the building lot by Fidelity Financial, Inc. in August 2001 for \$62,500 and also includes \$690 of associated property taxes paid. This sale is within \$4,100 of the land value reflected on the town's tax assessment records for the same timeframe. Four months later in December 2001, Fidelity Financial, Inc. resold the parcel to Freedom Train Realty Trust (related developer entity) for \$85,000 (an appreciation of 36% in four months!). Note that the CHAPA cost certification report reflected a more extreme adjustment of \$85,000 to bring the land to a zero value.

CHAPA and Melanson both identified that Champion Builders Inc. (Champion), the general contractor for the project, is a related party to the developer. Champion was paid a total of \$971,000. Included in this total was \$236,367 identified as contractor

overhead and management fee. Since this related party overhead and management fee charge was in excess (as reflected in the cost certification guidelines) of the prescribed maximum percentage of 14% of total construction costs, Melanson reported an adjustment of \$127,275 to bring these charges in line with the allowable percentage. CHAPA proposed a similar adjustment of \$100,427. The variance in cost adjustments is related to the use of a different cost basis by CHAPA than that used by Melanson.

Melanson also identified an adjustment of \$14,480 for interest paid to a related party at an interest rate in excess of the rate charged on the associated unrelated loan. This related party transaction was not highlighted in the financial statements submitted by the developer nor was it identified in the cost certification report prepared by CHAPA.

Other Melanson proposed cost adjustments include among other things \$8,550 for differences between charges claimed through the cost certification versus actual invoice amounts and approximately \$1,700 in developer costs that did not relate to the Cedar Farm Estates project.

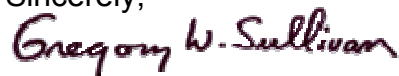
Although both the Melanson audit and the CHAPA cost certification identified significant differences (+16% and +17% respectively) in the project profits as reported by the developer, the total project profits are still below 20% and therefore no excess profit is owed to the town. In order to protect the interests of the town in future 40B developments, this Office makes the following recommendations:

- Developers should now be submitting land appraisals with their comprehensive permit applications. These appraisals should reflect the allowable acquisition value of the site which is the fair market value of the site excluding any value relating to the possible issuance of a comprehensive permit (the As-Is Market Value). The town should validate these appraisals against the most current real estate tax assessments for the site. Any differences in value greater than 5% should be investigated and resolved. Related party land transactions and the selling/transfer of land/comprehensive permits need special scrutiny.
- As part of the comprehensive permit application process, the developers should identify all related party activities including any financing arrangements. For these related party arrangements it is incumbent upon the town to understand the breakout of expected related party expenditures (direct versus indirect costs). Since these related party transactions are entered into without the benefit of a competitive bidding process and since higher development costs provide an opportunity/incentive for higher profits to be retained by a developer as opposed to being made available to the town for additional affordable housing initiatives it is imperative that the town understand these related costs including the associated overhead, general conditions and profit built into these relationships. The town should negotiate with the developer reasonable related party costs which will be included in the projects allowable costs and these agreements should be memorialized in the comprehensive permit and the regulatory agreement.

- The town should consider inserting itself in the cost monitoring process for the project and may even want to assume the role of monitoring agent. The town should be a party to the selection process for the public accounting firm which will perform the detailed cost certification audit and should also review the audit procedures to be performed in order to ensure that all concerns are addressed through the audit. These arrangements should be incorporated in both the comprehensive permit and the regulatory agreement.
- The town should ensure that included in the project agreements (comprehensive permit and regulatory agreement) are the requirements for a timely cost certification process. Looking specifically at the Cedar Farm Estates project, the CHAPA cost certification report was issued to the town sixteen (16) months after the last unit was sold in the development. This compares with a total of only fourteen (14) months for the project development, construction, marketing and sales cycles after ZBA project approval. The town and developer should agree to a reasonable timeframe for the developer to provide his financial statements to the monitoring agent. Consideration should be given to the assessment of reasonable penalties and the accrual of interest on any excess profits for late submissions.
- In order to help guarantee project completion according to the agreed upon plans and also to protect the town's interest in potential excess profits, consideration should be given to requiring the developer to post adequate bonds or other forms of security. These arrangements should be clearly articulated in the comprehensive permit and the regulatory agreement.

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

Sincerely,



Gregory W. Sullivan
Inspector General

Enclosures

Cc: Mr. Matthew J. Dacey
Mr. Aaron Gornstein
Mr. Thomas Gleason



Builders • Developers • Contractors

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RECEIVED

October 20, 2006

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OFFICE OF THE INSPECTOR GENERAL

Gregory W. Sullivan, Inspector General
The Commonwealth of Massachusetts
Office of the Inspector General
John W. McCormack State Office Building
One Ashburton Place, Room 1311
Boston, MA 02108

Dear Mr. Sullivan:

I am in receipt of your October 13, 2006 letter and the audit report prepared by Melanson Heath & Company, for which I thank you. The audit report concludes that our accounting practices, reporting, and tax returns all agreed to the general ledger and amounts reported. Although some of the adjustments taken by the auditors I question and could refute, i.e. (a) land value in Section 5 of the audit - the purchase price I paid to an unrelated third party was \$85,000.00, which was supported by a Deed and a check paid, not the adjusted figure of \$63,190.00 based on a town assessment; (b) questionable overhead calculations; and (c) miscellaneous documentation which can be corrected/supported. But since the end result is below the twenty percent (20%) allowable profit margin as reported by this audit, I choose not to refute these results at this time, as was advised by and discussed with both the auditors and yourself. Further, as a developer, builder, contractor and businessperson, who wears several hats operating in this field of business, this process penalizes efforts of qualified people to construct affordable housing.

Having been involved in the 40B Affordable Housing arena for more than twenty (20) years, I appreciate and look forward to the opportunity to provide input into this process, so as to clearly define the boundaries of all aspects of the 40B process. You had stated early on in the process that, at some point, this audit process would help define and update the 40B guidelines. I look forward to participating in that process.

Sincerely

Matthew J. Dacey
President

MJD/pr

Specializing in Affordable Single Family Custom Homes