



The Commonwealth of Massachusetts
Office of the Inspector General

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September 13, 2006

Mr. Thomas R. Gleason
Executive Director, MassHousing
One Beacon Street
Boston, MA 02108-3110

Dear Director Gleason:

The Office of the Inspector General is in the midst of a comprehensive review into the monitoring process of the limited dividend requirement associated with Massachusetts General Laws Chapter 40B. Ten (10) projects completed by 10 different developers in a diverse cross section of municipalities were selected at random for this review. The funding sources for all of these developments were either the New England Fund or the Housing Starts program.

This Office hired an independent certified public accounting firm, Melanson Heath & Company, P.C. (Melanson Health), to perform certain agreed upon procedures which are focused on verifying the income and expenses reported by the developers to the designated monitoring agents. Although our review is not complete, I want to share with you some of our concerns, especially since it appears that MassHousing may be moving in a direction which would further compromise the oversight process by excluding the municipalities from actively participating in the process as monitoring agents.

Based on our review to date, it has become clear to this Office that the cost certification and monitoring process is "broken." Our review has revealed that reported developer profits were routinely and substantially understated. The results, in many cases, were profit windfalls to the developers which deprived the respective municipalities of the excess profits that should have been paid to the municipality under the regulatory agreements. In these projects, developers apparently concealed profits by artificially inflating the costs of services performed by related parties, understating income by transferring property to related parties at discounts, and engaging in other accounting fictions. In performing this procedural review, Melanson Heath applied a standard protocol developed in conjunction with this Office to verify development costs and income and to determine the reasonableness of the related-party transactions. All 10 developers provided financial statements (audited in many cases by certified public accountants) for their projects which stated profits well below the 20% profit limitation. In general, the cost certification "audits" performed against these financial statements by

the appointed monitoring agent either failed to uncover or challenge these apparent abuses and reinforced the developers' understated profit margins.

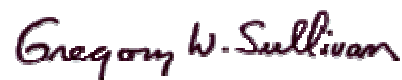
In the opinion of this Office, many municipalities have a false sense of security that effective cost certification monitoring and enforcement is being conducted by the subsidizing agencies on their behalf. The reality is that developers are taking advantage of a weak oversight system and are enriching themselves at the expense of the municipalities and their affordable housing initiatives. Thus, local initiatives to expand and create affordable housing, with these excess profits, have been thwarted by the apparent manipulation by developers in a poorly-monitored oversight system. This Office has noted that recent limited dividend monitoring efforts led by municipalities have resulted in the identification of significant excess profits similar to the experiences we have noted in our review to date.

Municipalities are key partners and players in the Chapter 40B process. They enable the development of affordable housing by providing the necessary zoning relief to the developers. They administer Community Preservation Act funds which are often used to subsidize affordable housing developments. They have significant vested interests in a fair and honest accounting of the project's profit. As a result, municipalities should be encouraged to actively participate in the oversight process. We understand, however, that MassHousing's policies and directions significantly limit the ability of municipalities to audit projects and to enforce the profit limitation requirements of Chapter 40B.

We understand that allowing municipalities unfettered authority to review 40B project cost certifications is probably not the solution. However, we firmly believe that the development of standardized protocols for limited dividend cost certifications and monitoring agent audits are in order. Moreover, municipalities should be encouraged to participate in the development of those protocols and be allowed to enforce developer noncompliance. This will help to ensure that all parties are playing by the same set of rules and make it clear to both the municipalities and the developers what monitoring is being done. This Office strongly recommends immediate changes to MassHousing's policy and guidelines to ensure that municipalities are actively inserted into the monitoring process for the limited dividend requirement.

I would like to arrange a meeting with you in order to discuss these findings/recommendations in more detail. I will be reaching out to you to set up a mutually agreeable time. If you have any questions or concerns before then, or if we can be of other assistance, please do not hesitate to call me.

Sincerely,

A handwritten signature in black ink that reads "Gregory W. Sullivan". The signature is written in a cursive, slightly slanted style.

Gregory W. Sullivan
Inspector General