



The Commonwealth of Massachusetts
Office of the Inspector General

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The Honorable Susan Tucker, Senate Chair
Joint Committee on Housing
State House, Room 424
Boston, MA 02133

The Honorable Kevin Honan, House Chair
Joint Committee on Housing
State House, Room 38
Boston, MA 02133

Dear Chairwoman Tucker and Chairman Honan,

As you hold a hearing on Chapter 40B, the Comprehensive Permit Law, I would like to take the opportunity to express some concerns regarding the practices associated with Chapter 40B. I am not writing to you in favor or opposition of any particular legislation, but rather on issues my office has identified as problems during the course of our review of developments created under Chapter 40B. These problems have led to the denial of funds to cities and towns for affordable housing.

Though Chapter 40B has been in existence since 1969, development activity did not heat up until the creation of the New England Fund as a subsidy source in the late 1990s. Thereafter there was a large increase in the number of for-profit developers who began to use Chapter 40B. The problems we have identified have been with these limited dividend corporations and a lack of oversight by both the subsidizing agencies and the state. While our review has only looked at ownership developments to date, there are indications that similar activities will be found in rental developments as well. A stronger role by the Department of Housing and Community Development (DHCD) is needed in order to curb the abuses that have taken place under Chapter 40B.

DHCD has permitted the subsidizing agencies to establish the financial rules that qualify developers for comprehensive permits. The subsidizing agencies also are responsible for regulating the individual projects. Subsidizing agency responsibilities include ensuring that developers are limited dividend organizations, that development costs and profits are reasonable and within program limits and that housing is sold or rented to income and asset-qualified households in compliance with fair housing laws. The regulatory agreement executed by the developer and the

subsidizing agency outlines the developer's responsibilities. The regulatory agreement will detail key elements or responsibilities for the project.

DHCD has also allowed subsidizing agencies to perform monitoring and enforcement of the affordability requirements imposed on a developer, as well as the compliance of a developer with the limited dividend requirement. Project monitoring of these projects is performed either by the subsidizing agency directly or by an organization called a monitoring agent under contract to the subsidizing agency. The monitoring agent purportedly acts on behalf of the municipality and the project administrator. The role of the monitoring agent is critical to the oversight and control of the Chapter 40B process.

Typically the regulatory agreement limits the profits of developers on a 40B home ownership project to no more than 20% of total allowable development costs and through this provision developers are deemed to be a "limited dividend organization" meeting the requirements set forth in Chapter 40B. All profits in excess of the allowable limits are required to be paid by the developer to the municipality. At the completion of a project the developer is required to deliver to the monitoring agent a "certified cost and income statement" (usually prepared by a certified public accountant) which summarizes gross income received by the developer from the project along with an itemized statement of total development costs. The monitoring agent is then responsible for reviewing and ensuring that the developer's profit is reasonable and within the established guidelines. The monitoring agent usually will hire a financial consultant to analyze the financial statements submitted by the developer. After completing the review, the monitoring agent will submit a cost certification of the developer's financial audit to the municipality involved.

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, my office sampled 10 completed Chapter 40B home ownership development projects for detailed review and analysis. Several recurring problems were identified through the audits of those cost certifications. The current Chapter 40B cost certification oversight process is ineffective in rigorously certifying developers' costs and profits. This office has determined that certain developers are able to inflate their expenditures and underreport their profits. As a result, municipalities are not receiving their fair share.

While the land acquisition values reported by Chapter 40B developers in their financial statements should be the as-is fair market value, without the benefit of a comprehensive permit, they are routinely in excess of that amount. Developers will often reflect the value of the land with the density benefit of a comprehensive permit. For example, one developer may apply for and receive the comprehensive permit, then sell the land and transfer the comprehensive permit to another developer at a higher price reflective of the approved density bonus. The second developer reports the higher land acquisition price in its financial statement. Because the reported values are higher, on paper the second developer shows a smaller profit margin than if the correct land value had been shown. In transfers of ownership between the time of site approval and cost certification the only excess allowable value is limited to services performed by the seller that would otherwise be includeable as an allowed line item such as architectural drawings. Economic benefit of the comprehensive permit shall accrue to the development and shall not be used to substantiate an acquisition cost greater than fair market value under existing zoning.

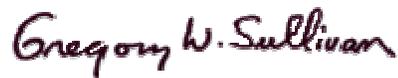
Another area of abuse is related-party transactions. This happens when a developer hires an entity that he is affiliated with to perform work on the project. This entity then charges the developer higher rates for the work. The developer shows this as an expense, without accounting for the financial interest he may have received through his affiliation. On paper it lowers the profits of the limited dividend corporation. A variation of this also happens when a developer sells off units to a related-party for prices well below market-rate. The developer shows this as a loss, thus lowering his profit margin.

To counter some of these abuses it will be necessary to establish a strong oversight function run by DHCD. Appraisers and monitoring agents or CPAs should be pre-qualified by DHCD. Cities and towns should then be able to choose the monitoring agents and CPAs from this list. A municipality should be allowed to act as a monitoring agent, as any excess profit belongs to them. They have a vested interest in assuring compliance with a cost certification process. Any issues pertaining to land value differences should be decided at the beginning of the process, not the end. All terms of agreements negotiated between a developer and the zoning board of appeals (ZBA) should be incorporated into a comprehensive permit. A ZBA should be able to require a developer to post a bond or to require the escrow of a certain percentage of funds until the cost certification is complete. The bond or escrowed funds would be used to pay the municipality if there are excess profits. Related-party transactions should be disclosed at the beginning of the process and full documentation should be required to justify the costs incurred. Most importantly of all, developers should be required to submit documentation to any public entity under the pains and penalties of perjury to ensure that honesty and integrity govern the developers' reporting process. Sanctions should be imposed for the violation of any laws or regulations relating to Chapter 40B.

I believe that these suggestions would go a long way to stopping the abuses occur under the current Chapter 40B process. I have also included copies of letters and reports that my office has released regarding our review of Chapter 40B. These documents may also be found on our website at www.mass.gov/ig/igpubl.htm.

If you have any questions, please feel free to contact me.

Sincerely,



Gregory W. Sullivan
Inspector General