



The Commonwealth of Massachusetts
Office of the Inspector General

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December 7, 2007

Mr. Michael S. Rosa
Chairman, Board of Selectmen
Town of Billerica
365 Boston Road
Billerica, MA 01821

Mr. Rocco J. Longo
Town Manager
Town of Billerica
365 Boston Road
Billerica, MA 01821

Subject: Chapter 40B Developer Profits – Salisbury Hill Corporation

Dear Chairman Rosa and Manager Longo:

This Office has completed its review of the cost certification and the associated limited dividend determination for the Salisbury Hill Estates housing development, which was built under provisions of M.G.L. c. 40B. In contrast to the developer's cost certification that represented to the town that there were no excess profits, this Office has identified approximately \$3,000,000 of excess profits owed by the developer to the town. The developer shielded profits from the town by inflating the expenses of the project, in particular by including in the Salisbury Hill Estates financials significant costs associated with other projects that were unrelated to the Salisbury Hill Estates project. The developer also understated the associated project revenues by not disclosing and accounting for certain below market unit sales. Accentuating this Office's concerns is the fact that the developer had previously tried to submit a bogus "audit" report to the monitoring agent.

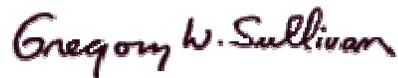
Enclosed are the detailed findings and recommendations based on our examination. Also included for your review and use is a copy of the Melanson Heath & Company, PC (Melanson) draft report. Melanson had been hired by this Office to perform the necessary agreed upon audit procedures for the Salisbury Hill Estates project and nine other developments selected for review. As you can see, this draft report was prepared by Melanson more than a year ago and a final report was never issued. In order to complete the audit, Melanson had identified major deficiencies in supporting documentation which were requested from the developer. The developer has not been forthcoming in producing these documents. This Office built upon the work already performed by Melanson and completed this review including the proposed adjustments (see Appendices 1 & 2) to the developer reported financial statements along with the associated impacts to excess profits for the development.

Prior to finalizing our report to the town, this Office provided preliminary findings, including the Melanson draft and adjusted financials, to the developer (Stephen Dresser) and his attorney (Edith Netter) for their review and comment. This recent correspondence is enclosed for your reference.

I hope that this information will be useful in recovering the excess profits owed to the town. The town should consider possible civil action proceedings against the parties involved in the Salisbury Hill Estates development. I also hope this report is useful to the town in planning and implementing future 40B housing developments. This Office plans to use the results of this audit along with the results from the other examinations in order to identify opportunities for improving the Chapter 40B oversight process, which in turn should help affordable housing initiatives throughout the Commonwealth.

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.

Sincerely,

A handwritten signature in dark ink that reads "Gregory W. Sullivan". The signature is written in a cursive style with a clear, legible font.

Gregory W. Sullivan
Inspector General

Enclosures

CC: Mr. Stephen Dresser, Salisbury Hill Corporation
Mr. David Way, Salisbury Hill Corporation
Mr. Joel Williams, Salisbury Hill Corporation
Ms. Edith Netter, Esq. Attorney, Salisbury Hill Corporation
Mr. Aaron Gornstein, Executive Director, CHAPA
Mr. Thomas Gleason, Executive Director, MassHousing
Ms. Tina Brooks, Undersecretary, DHCD
Ms. Doris Pearson, Chairman, Billerica Zoning Board of Appeals

**SALISBURY HILL ESTATES
TOWN OF BILLERICA
REVIEW OF COST CERTIFICATION PROCESS AND LIMITED DIVIDEND**

Executive Summary:

Salisbury Hill Corporation (Stephen Dresser; David Way; and, Joel Williams) the developer of Salisbury Hill Estates provided false and misleading financial statements to the town of Billerica. These financial statements or cost certification reports overstated the expenses and understated the revenues of the Salisbury Hill Estates housing development. The developer provided these false financial statements in order to shield profits from the town. The developer inflated project expenses by including significant costs in the financial reports that were associated with other projects and that were unrelated to the Salisbury Hill Estates project. The developer also did not disclose and account for certain below market unit sales. Through these financial machinations, the developer understated the project's profits and kept approximately \$3,000,000 of excess profit that rightfully belongs to the town of Billerica.

In addition to the valid development costs associated with the Salisbury Hill Estates project, the developer included unrelated costs directly associated with at least four other projects, including two in Tewksbury (Brown Street and Andover Street) and two in Billerica (Middlesex Turnpike/Canterbury Street and Rangeway Road). These projects were developed through related entities, including: Jasmine Development, LLC; Phel-Jas, LLC; Swanson Woods, LLC; and, Dresser, Williams and Way, Inc. None of these related entity activities were disclosed by the developer through the cost certification process.

The developer, in addition to including significant costs in the Salisbury Hill Estates financial statements that were associated with unrelated projects also employed other methods to inflate the reported development costs. These maneuverings included unsupported journal entries charged to development costs; purported sales commissions which were not paid to the sales broker; and, excessive related party developer overhead payments.

After the town approved the comprehensive permit, the developer through his attorney, submitted a revised regulatory agreement, which in essence redefined as an allowable development cost the land value of the site as the appraised value with a comprehensive permit. It is outrageous that the developer and his attorney would even suggest claiming as an allowable development expense a land cost nearly four (4) times what was actually paid. This revised language in the regulatory agreement runs counter to the legislative intent and the current and then existing guidelines for Chapter 40B developments. Although the developer and the subsidizing bank executed this revised regulatory agreement, this Office found no waiver from DHCD which would have been required in order to change the provisions of the then existing program guidelines. In the opinion of this Office the revised/executed regulatory agreement between the subsidizing bank and the developer (the town was not a party to this regulatory

agreement) contradicts the DHCD guidelines and lacks force with respect to the changes made by the developer and its attorney to the limited dividend section.

The developer had initially attempted to mislead the monitoring agent by submitting a cost certification audit report that reflected land acquisition costs for the project of \$2,270,000 (the appraised value with a comprehensive permit in place) versus \$610,000 (the actual amount paid by the developer for the site). The monitoring agent determined that the purported cost certification audit report submitted by the developer was not a bona fide audit report. The "independent auditor" was not a certified public accountant and the professed audit firm was not a genuine public accounting firm.

Based on the review of the Salisbury Hill Estates project and several other Chapter 40B developments, this Office has uncovered pervasive abuse by developers of the excess profit determination. The business relationship between subsidizing agencies/banks and the developers inhibit effective, meaningful and independent cost monitoring efforts. The cost certification process marginalizes the impact of monitoring agents such as CHAPA, as these agents are precluded from doing a thorough audit or investigation of the underlying financial transactions. The actual audits are conducted by "independent" certified public accounting firms which are hired by the developers. This often results in a less than independent project profit determination. These developer-contracted audits jeopardize the credibility of the limited dividend determination. An independent audit should provide for an open and transparent view of the underlying financial transactions and should not be controlled, managed or unduly influenced by the developer being audited. The subsidizing agencies have allowed and continue to allow this abuse-prone practice of developer commissioned audits.

This Office cautions all municipalities in dealing with project cost certifications to take a proactive role in negotiating, understanding and monitoring excess profits. Municipalities that abdicate this role to the subsidizing agencies/banks and to the developers put themselves at financial risk.

Background:

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 Salisbury Hill Estates project at Salem Road in Billerica which was developed by Salisbury Hill Corporation (Stephen Dresser, David Way and Joel Williams).

This Office contracted with the certified public accounting firm 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 reported 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 Salisbury Hill Estates project. Other guidelines from applicable subsidy programs and state agencies which help finance affordable housing developments were also consulted. The Melanson draft report was prepared more than a year ago and a final report was never issued. In order to complete the audit, Melanson had identified significant deficiencies in supporting documentation that were requested from the developer. The developer has not been sufficiently forthcoming in producing these documents. This Office built upon the work already performed by Melanson and completed this review including proposed adjustments (see Appendices 1-3) to the developer reported financial statements along with the associated impacts to excess profits for the development.

In August 2001, Stephen Dresser, President of Salisbury Hill Corporation, received a site approval or project eligibility letter from the Stoneham Cooperative Bank for this proposed Chapter 40B housing development in Billerica. The letter also indicated that the project appeared to be eligible for financing under the New England Fund Program of The Federal Home Loan Bank of Boston. The Zoning Board of Appeals (ZBA) for the town of Billerica granted approval for the Salisbury Hill Estates development in May 2002 and by mid March 2004 all 44 housing units (11 affordable; 33 market rate) were built and sold by the developer. The developer submitted to CHAPA, the monitoring agent, a phony audit report prepared by Merrimack Valley and dated March 9, 2005. Subsequent to the Merrimack Valley "audit" submission the firm of Feeley & Driscoll, P.C. (Certified Public Accountants) performed an audit of the project's financial statements on behalf of the developer. The accountant's report was dated August 2005. This financial report was submitted by the developer to CHAPA, who in turn completed the cost certification and submitted its report to the town in February 2006.

Comprehensive Permit Application

On August 31, 2001 the Billerica ZBA received a comprehensive permit application for the Salisbury Hill Estates housing development that was submitted by Edith Netter Esq., the attorney representing Salisbury Hill Corporation. The application included a schedule reflecting the project team which included Stephen Dresser, President Salisbury Hill Corporation as the Applicant and Project Engineer; and Rocco Scippa as the Real Estate Developer. The developer's credentials were also submitted by Netter. These credentials asserted among other things that Scippa had currently under construction an 8 unit townhouse project at 1375 Main Street in Reading, MA.

As part of our review of the Chapter 40B cost certification process, this Office had previously reviewed this particular Reading project. Our findings with respect to this project were published to the town of Reading in January 2007. Based on our experience with the Reading project, this Office has determined that the statement of

the developer's credentials submitted by Netter to the Billerica ZBA was inaccurate and misleading. Scippa had virtually nothing to do with the actual construction of the Reading project. Scippa was involved in the permitting phase of the project and was able to profit at the town's expense by not disclosing certain related party transactions that inflated the land valuation of the site. After obtaining the comprehensive permit, Scippa sold the land at a profit to an unrelated third party developer who actually constructed the project.

Comprehensive Permit and Regulatory Agreement:

Also included in the Salisbury Hill Estates comprehensive permit application submitted by Netter to the ZBA was a draft regulatory agreement. The dividend limitation section of this draft regulatory agreement incorporated the following condition: *"Developer agrees that the profit to the Developer or to the partners, shareholders, or other owners of Developer or of the Project shall not exceed twenty percent (20%) of total development costs of the Project, exclusive of development fees (the "Allowable Profit")."*

On May 1, 2002 the ZBA granted a comprehensive permit to Salisbury Hill Corporation for the Salisbury Hill Estates housing development. The comprehensive permit was approved with several conditions including the following: *"Prior to the issuance of any building permit, the Applicant shall submit the final draft of a Regulatory Agreement and Deed Rider to the Zoning Board of Appeals for approval, as to form, by its legal counsel, and the parties shall thereafter execute the Agreement."*

In a letter dated August 16, 2002, Netter submitted a revised draft regulatory agreement to Doris Pearson, (ZBA chairman). Under the dividend limitation section of the revised draft agreement was inserted additional language including the following:

"The Allowable Profit shall be measured as the excess of certified income, less any brokerage fees and commissions and selling expenses over the certified costs and less all development costs related to the Project including costs incurred by the developer as administrative and overhead costs which do not exceed four percent (4%) of total development costs, excluding such administrative and overhead costs. Acceptable development costs include, but are not limited to, the cost of site acquisition, defined as that land value, which can be underwritten by the Project and which, can be supported by the subsidizing entity's appraisal upon which its construction loan is based."

This language especially that which related to land valuation runs counter to the legislative intent of Chapter 40B, current guidance and then existing practices/guidance. The program guidelines promulgated by DHCD and in effect at the time the regulatory agreement was executed specifically addressed the land valuation issue as follows:

"For purposes of calculating total development costs and profit, an independent

appraisal is required to determine the allowable acquisition cost. Allowable acquisition cost shall not be unreasonably greater than the current appraised fair market value under existing zoning without a comprehensive permit in place. Economic benefits of the comprehensive permit shall accrue to the development and shall not be used to substantiate an acquisition cost that is unreasonably greater than the fair market value under existing zoning.”

The CHAPA monitoring guidelines in effect during this timeframe also focused on determining that the land value reflects the value of the site under its highest and best use without a comprehensive permit.

It should be noted that the developer had reflected a land cost of \$682,000 in his pro forma financials submitted to the subsidizing bank as part of the site eligibility application and to the ZBA as part of the comprehensive permit application. It is through these pro forma financials that the developer demonstrates that he is appropriately limiting his profits as a limited dividend organization. In September 2002, subsequent to these pro forma submissions, the developer purchased the land for a cost of \$610,000 which was reasonably close to the estimate in the pro forma financials. As part of the construction loan process, the subsidizing bank obtained a post permit land appraisal that valued the site at \$2,270,000 reflecting the added value of the issued 40B permit to the land. For the developer and his attorney to claim as an allowable development expense a land cost nearly 4 times what was actually paid represents a “bait and switch” tactic the intent of which was to deprive the town of the excess profits of the development.

This Office found no direct evidence that the ZBA assented to this revised draft agreement. There is no record that the ZBA ever met to discuss and/or vote on this proposed change. Although there is no formal record that the ZBA agreed to these revised terms, it is however apparent that developer subsequently obtained the necessary building permits to proceed with the project.

On March 20, 2003 Salisbury Hill Corporation entered into the formal regulatory agreement with the Middlesex Federal Savings Bank of Somerville, MA, as opposed to the Stoneham Savings Bank which had issued the original eligibility letter. The town of Billerica was not a party to this executed regulatory agreement. The dividend limitation section of this agreement between the developer and Middlesex Federal Savings Bank was consistent with the revised draft mentioned above; however, this agreement was inconsistent with the established DHCD guidelines which limited allowable land acquisition costs to the “as is” fair market value under existing zoning without a comprehensive permit.

Since there was no evidence of a formal acknowledgement and acceptance of the revised regulatory agreement by the town and since the language of the agreement is in opposition to the legislative intent and guidelines for Chapter 40B developments, this Office prepared two views of the adjusted project financials. These adjusted financials are reflected as Appendices 1 and 2. Appendix 1 reflects our audit

adjustments based on adherence to the original regulatory draft agreement and Appendix 2 reflects our adjustments in accordance with the terms of the executed regulatory agreement between the developer and the bank. It should be noted that the DHCD guidelines in effect at the time of execution of the regulatory agreement allowed that provisions to the guidelines could be waived by the Director of DHCD for good cause provided that any such waiver was consistent with applicable program requirements. This Office found no waiver from DHCD and therefore it is our opinion that the revised/executed regulatory agreement lacks force with respect to the changes made by the developer to the limited dividend section and therefore Appendix 1 is more indicative of the financial results of the project.

Certified Cost and Income Statement:

At the conclusion of the project the developer was required to deliver to the Citizens' Housing and Planning Association, Inc. (CHAPA), the monitoring agent for the development, a final Certified Cost and Income Statement certified by both the developer and a certified public accountant. It is through this cost certification process that the developer accounts for his profits. Profits in excess of 20% of the allowable development costs are payable by the developer to the town of Billerica.

In March 2005 (approximately one year after the last unit was sold in the development), Salisbury Hill Corporation (Steven Dresser) provided to CHAPA a purported cost certification report. This report (dated March 9, 2005) prepared by "Merrimack Valley" with an address listed as P.O. Box 457 Dracut, MA 01826 suggested that "Merrimack Valley" had conducted an audit of the maximum allowable profit for Salisbury Hill Corporation. The report indicated that the audit was conducted in accordance with auditing standards generally accepted in the United States of America and included other accounting/auditing boilerplate language. The report was signed by "Donald Bellemare, Independent Auditor". On receiving this purported cost certification report, CHAPA determined that Donald Bellemare was not a certified public accountant and that Merrimack Valley was not an independent certified public accounting firm. Due to these findings, CHAPA prudently rejected the report and instructed the developer to provide a cost certification audited by an independent certified public accountant.

Subsequent to this rejection, Salisbury Hill Corporation contracted with the certified public accounting firm of Feeley & Driscoll P.C. (Feeley) to perform the necessary cost certification audit. On August 12, 2005, Feeley completed the requested audit report. This new report was submitted by the developer to the monitoring agent. CHAPA conducted its independent review of the Feeley audit and notified the town on February 24, 2006 of the completed cost certification review.

The CHAPA review identified adjustments totaling \$322,373 (\$243,158 below market rate unit sales to revenue; \$9,215 of other overhead costs and \$70,000 of related party profit). Based on these adjustments, the revised profit percentage for the project became 18.1% which was still below the 20% threshold and therefore no excess

profits were identified.

Highlighted in the chart below, for comparative purposes, are key financial representations reflected in each of the three cost certifications.

	Merrimack	Feeley	CHAPA
Total Sales	\$9,244,200	\$9,010,802	\$9,253,960
Land Acquisition Costs	\$2,270,000	\$610,000	\$610,000
Hard Development Costs	\$4,948,879	\$6,252,639	\$6,182,639
Total Project Costs	\$8,369,221	\$7,914,775	\$7,835,560
Computed Profit	\$874,979	\$1,096,027	\$1,418,400
Profit Percentage	10.5%	13.8%	18.1%
Excess Profit	\$0	\$0	\$0

It is important to note that the original (Merrimack) financials submitted by the developer to CHAPA and which were rejected by the monitoring agent reflected a land acquisition cost of \$2,270,000 (consistent with a post-permit appraisal value and not the actual cost paid) and the Hard Development Costs totaled \$4,948,879. The subsequent financials which were audited by Feeley and were submitted to CHAPA by the developer reflected a land acquisition cost of \$610,000 (consistent with the actual cost paid for the site which was contingent on a comprehensive permit approval) and included Hard Development Costs totaling \$6,252,639 or \$1,303,760 higher than had been reflected in the previously submitted (Merrimack) financials.

The fact that the developer had originally provided false and misleading financial statements to the monitoring agent and also the fact that the subsequent audited financials contain significant discrepancies from the first submission raises considerable concerns regarding the veracity of the numbers reported by the developer. These discrepancies and related concerns are discussed in detail in subsequent sections of this report.

CHAPA Review:

The audited financial statements prepared by Feeley and provided by the developer to CHAPA reflected total sales of \$9,010,802 and total development costs of \$7,914,775 with an associated profit of \$1,096,027 or 13.8% of total development costs.

The CHAPA cost certification of these audited financials uncovered two housing units which were sold at below market rates. This finding is reflected in the CHAPA certification report as follows:

“Unit 21 was sold to Charlene McCarthy (the broker) for \$138,940 and valued at \$216,642 in the audit or \$13,258 below market. Unit 111 was sold to Mary Carron (seller of a parcel of land) for \$1 and is valued at \$0 in the audit or \$229,900 below market. We recalculated the profit by adding to market unit sales revenue \$243,158 (\$13,258 plus \$229,900) which resulted in a revised profit of \$1,339,185 or 16.9%.”

With respect to related party transactions, CHAPA performed an alternative analysis to reflect inclusion of the profit retained by related parties as profit rather than a project cost in the calculation of allowable profit. This alternative analysis is documented in the CHAPA cost certification as follows:

“Total related party activity was \$422,320, and the portion of this amount which was retained as profit by the related party was approximately \$70,000 according to the audited footnotes prepared by Feeley & Driscoll. Backing the \$70,000 out of total development costs of \$7,914,775 results in a revised profit percentage of 14.86%, which falls below the allowable 20% profit. Since the revised profit percentage based on related party profit does not exceed the allowable profit limit, further review does not appear to be warranted.”

The CHAPA cost certification also identified several cost line items included in the audited financial statements which did not appear to be directly related to development of the site and which were not included in overhead. These costs totaled \$9,215 and included office supplies, postage and delivery and miscellaneous expense. The CHAPA report indicated that if these line items had been excluded from total development costs, the profit would become \$1,105,242, or 13.98%. Since this profit percentage was still below the allowable 20% maximum, CHAPA determined that further review of these costs did not appear warranted.

In summarizing the adjustments, CHAPA concluded that *“If we add back all of the adjustments noted above of \$322,373 (\$243,158 below market rate unit sales to revenue; \$9,215 of other overhead costs and \$70,000 of related party profit) the revised profit percentage is 18.10% which is still below the 20% threshold.”*

OIG/Melanson Review:

In contrast to the audit report/cost certification provided by the developer and the associated CHAPA review, our investigation highlighted significant adjustments, especially with respect to unsupported expenses and undisclosed related party transactions which result in excess development profits owed to the town. The OIG/Melanson review determined that the developer underreported his profitability by \$3,000,001 by reporting \$2,756,843 in unsupported expenses and by overstating sales revenue by \$243,158 (consistent with the CHAPA review). The combined increase in revenue and the reduction in development costs results in an offsetting increase to the net profit for the development. In the final cost certification report provided to CHAPA,

the developer reflected a 13.85% profit percentage. Based on our investigation and the related adjustments this Office has recalculated the project's adjusted profit as a percentage of total development costs to be 79.41% (Appendix 1 - Original Draft Regulatory Agreement) or 70.40% (Appendix 2 – Revised/Executed Regulatory Agreement) The resulting excess profit for the development is determined as \$3,064,442 and \$2,737,239 respectively versus the zero excess profit previously submitted by the developer.

Unsupported Expenses - Missing Documentation:

A major focus of our investigation was on validating the development costs reflected in the developer's cost certification through an examination of the supporting documentation including but not limited to such back-up as vendor invoices, timesheets, contracts and other agreements. Since the developer was unable or unwilling to provide documentation in support of approximately \$1,300,000 or 16% of the total purported development cost for the project, this Office made the associated adjustments to the financials as reflected in Appendices 1 & 2. Prior to making these adjustments, this Office attempted to work with the developer in order to obtain these records. In July 2006 this Office provided an 18 page report to the developer which documented the missing invoices. The developer agreed to provide available supporting documentation on a phased delivery schedule (4 pages per week). Over a year later, we received minimal production of the requested documents from the developer.

In our efforts to validate and understand the development costs, this Office obtained pertinent documents from a variety of sources including: Feeley (audit workpapers); Middlesex Federal Savings Bank (construction loan related documentation); and, American Dream Homes, Inc (broker commissions). As is referenced below, these documents were useful in our analysis and investigation of development costs.

At a macro level, this Office compared for reasonableness and consistency the assorted filings or statements made by the developer at various times regarding estimated and actual development costs. Documents reviewed included the following: the original pro forma financial submitted by Netter as part of the comprehensive permit application; construction loan agreement with Middlesex Federal Savings Bank; building permits issued to the developer by the town; original cost certification report (Merrimack) submitted by the developer to CHAPA; and, final cost certification report (Feeley audit) submitted by the developer. Summarized in the chart below are the Building Construction Costs, the Site Development Costs and the Total Hard Development Costs based on these key snapshot views of the development costs. The Building Construction Cost of \$3,951,200 reflected under the original pro forma was pro rated based on a 44 unit development versus the original request by the developer to the ZBA for 56 units. The building permit costs reflect both the permits for the foundation construction costs and the building construction costs.

	Building Construction	Site Development	Total Hard Dev Costs
Original Pro Forma	\$3,951,200	\$600,000	\$4,551,200
Bank Loan Documents	\$3,960,000	\$693,000	\$4,653,000
Building Permits	\$3,749,625	N/A	N/A
Merrimack	\$4,066,986	\$881,893	\$4,948,879
Feeley	\$4,810,013	\$1,442,626	\$6,252,639
OIG Adjusted Balances	\$3,631,625	\$451,106	\$4,082,731

As can be seen in the chart above the development cost estimates reflected in the building permits, the construction loan documents and the original project pro forma are stable and relatively consistent. The original bogus cost certification report prepared by Merrimack and submitted by the developer to CHAPA also reflected a fairly consistent view of the “actual” development costs. In total, the hard development costs in the Merrimack “audit” were within 9% of the previous estimates provided to the town and the bank by the developer. After CHAPA challenged the Merrimack audit report, the developer resubmitted a cost certification report which was audited by Feeley, an independent certified public accounting firm hired by the developer. This final cost certification report prepared by Feeley and submitted by the developer reflects a significant increase of \$1,303,760 in the hard development costs versus what had previously been reported by Merrimack.

As discussed in more detail below, it is apparent that the developer has included costs in the final Salisbury Hill Estates cost certification which are not related to this development. This action was apparently precipitated by CHAPA’s rejecting the false Merrimack cost certification. The Merrimack cost certification included a land cost of \$2,270,000. The final cost certification report audited by Feeley included the actual land acquisition cost of \$610,000. It appears to this Office that once the developer realized that he could not justify the inflated land cost he proceeded to include additional hard development costs in order to maintain a profit percentage below the 20% requirement thus shielding excess profits from the town.

Also as reflected in the chart above, this Office was able to validate through review of supporting documentation hard development costs for the Salisbury Hill Estates project of \$4,082,731. The adjustments related to these hard development costs are reflected in Appendices 1 & 2. These validated costs are more in line with the other financial submissions as opposed to the final cost certification prepared by Feeley and submitted by the developer.

Although the developer did not provide supporting documentation for approximately \$1,300,000 of the development costs, this Office was able to determine that many of these costs are clearly related to other projects and should not be included as part of the Salisbury Hills Estates project financials and associated cost certification reports. During this timeframe, the developer through related entities was engaged in several other development projects including two in the town of Tewksbury (Brown Street and Andover Street) and at least two other projects in Billerica (Middlesex/Canterbury Street and Rangeway Road). These related entities are

discussed in more detail in the related party sections below. Through alternative verification procedures, we were able to identify payments totaling approximately \$540,000 made by the developer (Salisbury Hill Corporation) on behalf of these affiliated entities but which were improperly charged against the Salisbury Hill Estates housing development. As an example, we obtained supporting vendor back-up from sources other than the developer to validate payments such as those made to Costello and Landrigan as part of the settlement for the purchase of the two building sites in Tewksbury (Brown Street and Andover Street). This Office is of the opinion that the majority of the remaining \$780,000 in costs that the developer did not provide supporting documentation for may also be associated with projects unrelated to the Salisbury Hill Estates housing development.

Unsupported Expenses – Adjusting Journal Entries:

Our examination included a review of all journal entries in the developer's general ledger for the purpose of determining if the entry had a sound accounting basis and appropriate back-up. Journal entries were used to record payroll entries and bank deposits which resulted in an appropriately large number of journal entries. Additional expected entries were for such purposes as moving construction costs from inventory accounts to costs of good sold, and recording the sales of the units. Melanson noted that the sales of units to the corporation's principals (see Underreported Sales section below) were recorded through journal entry as a sale and distribution to the individuals. Melanson determined that this was the appropriate accounting entry for these transactions.

The majority of these journal entries appeared to be valid and appropriate for this project. There were, however, two journal entries which we questioned and requested supporting back-up documentation. This back-up support was not provided by the developer and we therefore made adjustments to the developer submitted cost certification report for these unsupported journal entries. ADJ 17 booked by the developer in December 2003 included a curious charge of \$393,312 to Common Costs with offsetting credits to stockholder's equity accounts. A reclassification entry in 2005 included an additional \$82,187 transferred from the Land Inventory account to Common Costs. This Office adjusted the developer reported financials for these two journal entries. The net effect of our adjustments for these unsupported journal entries is to reduce the total project expenses by \$475,499 with a direct and comparable increase to the reported profit for the development.

Underreported Sales Revenue:

Our investigation determined that Salisbury Hill Corporation underreported by \$243,158 the sales revenue associated with the Salisbury Hill Estates development. A total of forty-four (44) home ownership condominium units were developed. Eleven (11)

of the units were sold to affordable buyers. The remaining thirty-three units were targeted to be sold at market rates. A detailed review of these market rate unit sales uncovered that 2 of these units were sold at below-market prices. Our finding with respect to this underreported revenue is consistent with CHAPA's review of the cost certification audit.

In July 2003, Unit 111 was sold to Ms. Mary Carron for a recorded price through the registry of deeds of \$1.00. The comparable market rate price at the time of sale was \$229,900. The \$1.00 sales price was the value incorporated and reported through the developer's cost certification submitted to CHAPA. Carron was the previous property owner of two of the three parcels which comprise the Salisbury Hill Estates development. It should be noted with respect to the acquisition of the Carron parcels by Dresser that the purchase and sale agreement provided by Netter/Dresser to the town to demonstrate site control did not disclose any special agreement for a below market unit sale to Carron. The representations made by the developer to the town were that this unit along with 32 other units would be sold at market rates.

In February 2004, Unit 21 was sold to Ms. Charlene McCarthy for a recorded sales price through the registry of deeds of \$138,940. The comparable market rate price for this unit at the time of sale was \$229,900. McCarthy is the principal of American Dream Homes, Inc. which was the contracted sales broker for the market rate units in the development. Although the recorded sales price to McCarthy is only \$138,940; the actual sales value incorporated and reported through the developer's cost certification submitted to CHAPA was \$216,642. The additional \$77,702 represents recognition of broker's commissions owed to McCarthy for sales of units in the Salisbury Hill Estates project. This broker arrangement is discussed in more detail in the Broker Sales Commission section below. The \$216,642 reported in the developer's cost certification was \$13,258 below the market rate value of \$229,900. In May 2005, McCarthy resold this housing unit for \$306,000.

We found no evidence that these below market sales were ever disclosed to the town by the developer. We have included an adjustment of \$243,158 (\$229,900 - Carron unit and \$13,258 - McCarthy unit) to market unit sales revenue.

There also were three other housing units which were sold for a recorded price through the registry of deeds of \$1.00 each. These units were sold to the stockholders of the development entity (Stephen Dresser; David Way; and Joel Williams). Although the recorded sales prices for each of these three units is \$1.00 the actual sales value incorporated and reported through the developer's cost certification submitted to CHAPA reflects market value of \$687,000 for the three units combined and therefore, no adjustment to the cost certification is proposed for these stockholder acquired units.

Broker Sales Commissions:

On June 19, 2002 American Dream Homes, Inc. (Charlene McCarthy) entered into an "exclusive rights to sell listing" with Stephen Dresser for 29 market rate units in the Salisbury Hill Estates development. A four percent (4%) commission rate was agreed to for the advertising and marketing of these 29 market rate units. Although 33 market rate units were included in the development, 4 of these units (those sold to Mary Carron, David Way, Joel Williams and Stephen Dresser) were excluded from this exclusive agreement. For additional information regarding these four excluded units, see the "Underreported Sales Revenue" section above.

The Feeley cost certification provided by the developer to CHAPA reflected a separate "broker commission" expense category totaling \$323,988. The developer provided a detailed schedule of commission costs by housing unit supporting the total expense claimed on the cost certification. The schedule reflected a 4% commission rate against the base unit sales price for 39 of the 44 housing units in the development. There were 5 housing units which had no related commissions; these included the three units sold to the stockholders in the development (Dresser, Way, and Williams), the unit sold to the prior landowner (Carron) and the unit sold to the broker (McCarthy). The 39 units which reflected a 4% commission cost included the 11 affordable housing units. Of the total broker commission expense claimed by the developer, \$69,300 was related to the affordable housing units. Buyers for the affordable units were determined through a lottery process which was conducted by a consultant (Jill Onderdonk) and who was paid by the developer through the project. CHAPA as monitoring agent for the development oversaw the lottery process.

Commissions totaling \$276,688 (not the \$323,988 reflected in the developer's cost certification) were actually paid to American Dream Home Inc/Charlene McCarthy for the 39 units identified above. Commissions at a 4% rate for eighteen (18) of the market rate units (\$163,728) were paid by check to American Dream Homes. Commissions on the other ten (10) market units (\$90,960) were not disbursed by check; instead this obligation from Salisbury Hill Corporation was used to lower the purchase price ($\$229,900 - \$90,960 = \$138,940$) of the unit purchased by McCarthy. In addition to these broker commissions related to the market rate units, McCarthy/American Dream Homes received \$22,000 or \$2,000 for each of the eleven affordable units sold in the development. Since \$69,300 was included as affordable commission expense in the cost certification report and since only \$22,000 was actually paid out, this Office adjusted the commission expenses by \$47,300 ($\$69,300 - \$22,000$).

In addition to the \$323,988 reflected in the Broker's Commissions account this Office found that the developer had entered through journal entry in the general ledger a comparable commission expense also totaling \$323,988 and charged to the Building Construction account. This Office made an adjustment to the financial statements which reduced the Building Construction costs by \$323,988 for this apparent double entry of expense. This Office understands that a reclassification entry may have been made by the developer that would properly account for this apparent double counting of expense.

This Office requested that the developer provide back-up support for this reclassification, however, none was provided.

Related Party – Dresser, Williams & Way, Inc.:

Dresser, Williams & Way, Inc. (DWW) is a civil engineering and land planning firm in Billerica. The principals of DWW (Stephen Dresser, Joel Williams and David Way) are also stockholders in Salisbury Hill Corporation; the developer of Salisbury Hill Estates. DWW was paid a total of \$476,320 by Salisbury Hill Corporation; \$54,000 of which was a loan repayment leaving a net vendor payment to DWW of \$422,320.

The \$422,320 paid to DWW was charged against three expense accounts: \$218,576 for Developer Overhead; \$174,401 for Common Costs; and, \$29,343 for Engineering, and was included in the cost certification report provided by the developer to CHAPA. Based on input received from Dresser, the services provided by DWW to Salisbury Hill Corporation include the following: preparation of civil engineering plans; preparation of a site survey; supervision of the site development; consultancy on the financial aspects of the project; and, oversight of the lottery and the real estate brokerage. Dresser approximated the dollars associated with each of these activities. This approximation is as follows: Civil Engineering (\$82,555); Development Supervision (\$104,500); Project and Financial Consulting (\$28,600); Land Surveying (\$92,652); Real Estate Brokerage Oversight (\$90,108); and, Lottery Oversight (\$23,906). All of these functions or activities except for the Land Surveying were performed by the partners of DWW/principals of Salisbury Hill Corporation. Employees of DWW performed the Land Surveying activities. Dresser indicated that DWW employees spent a total of 930 hours with associated billing rates between \$75 and \$125 per hour arriving at the estimated Land Surveying cost of \$92,652. The Civil Engineering, Development Supervision and the Project/Financial Consulting activities were all performed by DWW partners at total estimated hours of 750.5; 950; and 260 respectively. The billing rate provided by Dresser for these activities was \$110 per hour. Dresser did not provide a breakout of the billing rates in terms of actual labor expense, overhead, and profit comprising the individual rates.

Although the total dollars reconciled, we were unable to correlate the activity totals above provided by Dresser, against the three expense accounts (Development Overhead, Common Costs and Engineering) reflected in the general ledger and the cost certification report.

We were not provided with employee time sheets to validate the employee hours spent on Land Surveying. Also as indicated above, we were not provided with details regarding the hourly billing rate. In this Office's opinion, this Land Surveying cost of \$92,652 appears excessive for this development. Typically allowable costs for related party transactions include actual costs paid for labor and materials and provide for a 14% markup to cover profit and overhead. We did not make any related adjustments to the financial statements for these costs, even though we believe they are excessive and

we were unable to validate them. The town should consider if additional inquiry and analysis is warranted.

With respect to the other costs associated with all the activities attributed to the partners of DWW, who are also stockholders of the development entity, we booked an adjustment of \$111,092 in order to reclassify these costs from Common Costs to Developer Overhead. These Developer Overhead costs reflect developer related activities associated with administering and managing the project during the permitting, financing, construction, marketing and cost certification phases of the project. The executed regulatory agreement, unlike the original draft, permitted as an allowable development cost those administrative and overhead expenses incurred by the developer which do not exceed four percent (4%) of total development costs, excluding such administrative and overhead costs.

Some of these related party Developer Overhead costs appear reasonable while others do not seem consistent with an affordable housing initiative. Examples are reflected below:

1. Dresser indicated that for its work coordinating with the lottery agent who ran the affordable housing lottery, DWW was paid \$23,906 for lottery oversight. He contends that it would be reasonable to pay 3% of the sum of actual affordable unit sales prices for lottery costs. Note in November 2005 the Massachusetts Housing Partnership and Attorney Netter published a 40B guidebook titled, "Local 40B Review and Decision Guidelines", which reinforced this 3% standard. This Office finds outrageous that the lottery agent was paid \$1,110 while the lottery "oversight" fee paid to this developer related entity was \$23,906, more than 21 times greater than the actual lottery service provided by the independent consultant. In addition, the project also paid CHAPA to be the monitoring agent for this development. As monitoring agent, one of the duties performed by CHAPA was to oversee the lottery process.

2. Dresser also indicated that as a function of working with the realtor, DWW was paid \$90,108. The exclusive realtor for the project (American Dream Homes, Inc/Charlene McCarthy) was paid a 4% commission. Dresser contends that it would be typical to pay a commission of 5% and therefore DWW would be entitled to the other 1% or \$90,108. None of the common principals (Dresser, Way, and Williams) in DWW and Salisbury Hill Corporation are licensed real estate brokers. This Office finds that allowing developers to extract profits from a development based on a blanket percentage and not on actual services provided is offensive and counterproductive to affordable housing development. It should be noted that six (6) additional market rate units could have been sold to affordable buyers if these "development overhead" costs paid to the development principals were instead used to buy-down the market rate units to affordable levels.

Related Party – Jasmine Development, LLC:

In December 2003, the principals of Salisbury Hill Corporation (Stephen Dresser, David Way and Joel Williams) organized Jasmine Development, LLC (Jasmine) a domestic limited liability company for the purpose of developing real estate. In March 2004 (the same month that the last Salisbury Hill Estates housing unit was sold), Jasmine proposed a 12 unit housing project at Brown Street in Tewksbury.

During 2004 Jasmine incurred certain development related expenses for the Brown Street project. These Jasmine/Tewksbury expenses were paid for through Salisbury Hill Corporation and were subsequently improperly reported as Salisbury Hill Estates project costs through the cost certification process. These costs reflected on the Salisbury Hill Estates cost certification had the effect of inflating the project costs and shielding excess profits from the town of Billerica. The developer also failed to identify Jasmine Development LLC as a related party in the cost certification schedules provided to CHAPA and the town.

On December 31, 2004 an adjusting entry (ADJ DTJ) for \$79,390 of Jasmine/Tewksbury related project expenses was inappropriately recorded by the developer against Common Costs in the Salisbury Hill Estates cost certification reports. In addition, this Office identified, that included in the Salisbury Hill Estates financial reports were payments made by Salisbury Hill Corporation to Costello & Landrigan (\$95,760) and Private Properties (\$31,000) as settlement for the purchase of 115 Brown Street in Tewksbury. Other costs that this Office was able to identify that were paid by Salisbury Hill Corporation on behalf of the Jasmine Development, LLC project in Tewksbury and improperly included in the cost certification financial report for the Salisbury Hill Estates development include: Abend Associates (\$2,800); Town of Tewksbury (\$1,496); and, Environmental Research (\$425). Also included under Common Costs for the Salisbury Hill Estates project was \$8,122 paid to Middlesex Federal Savings Bank as part of a loan repayment. These costs were related to the Brown Street/Jasmine project in Tewksbury and should not have been reflected in the cost certification report for Salisbury Hill Estates in Billerica. This Office has recorded appropriate adjustments to eliminate these costs from the Salisbury Hill Estates project financials.

Related Party – Phel-Jas LLC

In January 2004, Phel-Jas LLC was created for the purpose of developing real estate. Dresser and Joseph J. Phelan III are identified through the Commonwealth's Secretary of State website as the managers of this domestic limited liability company. Based on a review of bank documents, it appears that Dresser, Williams & Way, Inc. (the same principals as the Salisbury Hill Estates development) owns 66.6% of Phel-Jas and the remaining ownership is attributed to Phelan. In 2004, Phel-Jas proposed a 24 unit 40B housing development on Andover Street in Tewksbury.

This Office found that costs associated with this Andover Street development in Tewksbury were paid through Salisbury Hill Corporation and were improperly included

in the cost certification financials for the Salisbury Hill Estates development. This resulted in the developer understating the actual profits for the Salisbury Hill Estates development which in turn resulted in a loss to the town Billerica since excess profits that should have been disclosed and paid to the town were hidden and kept by the developer. This Office identified payments made by Salisbury Hill Corporation to Costello & Landrigan (\$74,452) as the settlement agent for the purchase of 1582 Andover Street in Tewksbury. Other costs that this Office was able to identify which were paid by Salisbury Hill Corporation on behalf of the Phel-Jas project in Tewksbury, but improperly included in the cost certification financial report for the Salisbury Hill Estates development included: J.J. Phelan & Sons, Inc. for \$46,495 and MassHousing for \$3,220.

Related Party – Swanson Woods, LLC

In July 2002, Swanson Woods, LLC was created for the purpose of real estate development. Based on a review of bank documents, it appears that Dresser, Williams, and Way, Inc has a 25% ownership interest in this domestic limited liability company. Swanson Woods, LLC owns property on Rangeway Road and Sullivan Road in Billerica.

This Office found a payment totaling \$4,000 made by Salisbury Hill Corporation directly to Swanson Woods, LLC. This payment to a related development entity was included in the cost certification financials for the Salisbury Hill Estates development. There was no supporting back-up provided to this Office by Dresser to demonstrate that this payment was for services provided by Swanson Woods, LLC for the benefit of the Salisbury Hill Estates development. This payment to a related or affiliated entity was never disclosed by the developer through his cost certification to the town. This Office has made an adjustment to the financials removing this payment as a Salisbury Hill Estates allowable development cost.

Related Party – Middlesex Turnpike/Canterbury Street Project

In August 2003, Dresser, Williams and Way, Inc. (the same principals as the Salisbury Hill Estates Development) purchased property at 469 Middlesex Turnpike in Billerica from Lucien Carter for \$219,375. In March 2004, this property was resold by Dresser, Williams and Way, Inc. to Gilberto and Andreia Oliveira for the sum of \$499,900. Prior to the resale, improvements were made to the property which resulted in a change in the address of 469 Middlesex Turnpike to 1 Canterbury Street.

This Office found that costs associated with this Middlesex Turnpike/Canterbury Street project in Billerica were paid through Salisbury Hill Corporation and were inappropriately included in the cost certification financials for the Salisbury Hill Estates development. This resulted in the developer understating the actual profits for the Salisbury Hill Estates development which in turn resulted in a loss to the town of

Billerica due to excess profits not being properly disclosed. Some of these charges which were improperly reflected as Salisbury Hill Estates development costs included settlement costs associated with the original purchase of 469 Middlesex Turnpike and paid through Milik & Medeiros, PA - \$209,938. Other costs related to the Middlesex/Canterbury project which were improperly included as parts of the Salisbury Hill Estates development were payments to: Powderly & Sons -\$9,384; Roger Carey - \$8,652; D. Crescio Trucking Co. - \$6,610; Brunelle Brothers - \$3,200; Timothy Proia - \$1,300 and American Garage Door - \$682.

Related Party – Rocco Scippa:

As previously noted, Mr. Rocco Scippa was identified in the comprehensive permit application submitted by Attorney Netter as the real estate developer on the project team for the Salisbury Hill Estates development.

In September 2002, Scippa along with Mr. Barry Doherty entered into an agreement with Salisbury Hill Corporation (Dresser). The agreement provided that Scippa and Doherty were granted 50% of all profits (after certain specific deductions) from the Salisbury Hill Estates project in exchange for Scippa and Doherty paying all closing costs, including the money required by the bank to complete the land purchase.

Scippa received payments totaling \$427,000. Of this amount paid to Scippa; \$400,000 was recorded as “professional fees – commissions”; \$15,000 was reported as “common costs” and \$12,000 was reported as “development overhead”. The \$400,000 in commissions, although reflected in the general ledger, was not reported in the cost certification as a project expense. The Feeley audit, which was the basis for the final cost certification submitted to CHAPA, disallowed these distributions of profit paid to Scippa which were misrepresented as a Salisbury Hill Estates project cost. We agree with the adjustment made by Feeley and therefore we propose no further adjustment to this related party distribution. It should be noted that similar profit distributions (\$310,000 for Doherty and \$100,000 for J.J. Phelan & Son) which were improperly charged to the professional fees – commissions account were also disallowed through the Feeley audit.

This Office was not provided with any back-up documentation supporting the \$15,000 paid to Scippa which was reported as common cost through the cost certification. Due to this lack of back-up documentation, this Office made an adjustment to the cost certification reducing common cost expense by \$15,000. This Office also was not provided with documentation to support the \$12,000 paid to Scippa and charged to development overhead. Adjustments for this account are addressed in the Development Overhead section.

Taxes:

Under Soft Costs in the developer provided cost certification was \$37,454 in "Tax" cost. Of this total, \$25,981 was paid to the Commonwealth of Massachusetts as an S Corporation Excise tax for Salisbury Hill Corporation. Since this cost is not related directly to the Salisbury Hill Estates housing development, but is rather an overhead expense of the development entity, we reclassified and transferred the expense into Development Overhead. This is discussed in more detail in the Development Overhead section.

Salaries & Payroll Expenses:

Included in the developer's cost certification report under Soft Costs was a Salaries account totaling \$107,070 and a Payroll Expenses account totaling \$2,414. The Salaries account was comprised primarily of payments made to an employee of Salisbury Hills Corporation who was identified as the site supervisor for the Salisbury Hill Estates development. Due to a lack of supporting documentation (blank timesheets), \$29,784 of this Salary expense was adjusted out of the cost certification balance. Most of these charges where documentation was lacking pertained to a timeframe which occurred after the sale of the last housing unit in the Salisbury Hill Estates housing development. Although the documentation was lacking, it appears that these costs were not related to the Salisbury Hill Estates development but were associated with a different project undertaken by Jasmine Development (a related party) and Salisbury Hill Corporation in Tewksbury.

The remaining \$77,286 in Salary Expense and the \$2,414 in Payroll Expenses which reflect expenses of the developer in administering and managing the project were reclassified by this Office to the Development Overhead account. The Development Overhead section above contains additional information and clarification.

Other Miscellaneous Adjustments to Costs:

Other cost adjustments include; a \$5,400 reduction to Building Construction due to duplicate payments; a reduction of \$2,154 to Miscellaneous expense to adjust for the variance between total costs reflected on the general ledger versus a higher total reported on the cost certification; a reduction totaling \$1,065 (\$665 – Building Construction & \$400 – Subcontractors) for non-project related expenses charged to the Salisbury Hill Estates development; and, a reduction in insurance expense due to a payment in excess of the invoice amount (\$124).

Development Overhead:

The cost certification report audited by Feeley and submitted by the developer to CHAPA reflected Development Overhead costs totaling \$266,766. This Office and Melanson reviewed the detail charges to this account and based on this review reclassified \$9,615 from Development Overhead into the Common Costs account. This adjustment was for appropriate project related payments made to the town of Billerica for police details. Through our review of the detail charges to the account, we also reduced Development Overhead by \$36,574. This adjustment was made since the developer did not provide documentation in support of these charges and includes \$12,000 paid to Scippa with no back-up. The resulting Development Overhead balance is comprised primarily of payments made to DWW a related party to the developer.

In addition to the adjustments referenced above, this Office made several reclassification adjustments increasing the Development Overhead account by transferring balances from other expense accounts. These reclassification adjustments included transfers from the following accounts: \$111,092 – Common Costs; \$77,286 – Salaries; \$25,981 – Taxes; and, \$2,414 – Payroll Expenses. As is discussed in the related sections of this report (DWW Related Party; Taxes; and Payroll Expenses), these reclassified costs represent developer overhead expenses in administering and managing the project and are therefore more appropriately categorized as Developer Overhead.

The executed regulatory agreement between Salisbury Hill Corporation and Middlesex Federal Savings Bank provides that costs incurred by the developer as administrative and overhead expenses which do not exceed four percent (4%) of total development costs are an allowable development expense. Based on this regulatory agreement, up to \$208,869 of development overhead would be an allowable expense in determining the allowable profit for the development. Based on this guidance, we implemented an adjustment of \$228,481 to Developer Overhead in order to cap this expense at the prescribed level. This adjustment is reflected in the revised financials depicted in Appendix 2.

Since it is not clear that the town actually agreed to the revised and executed regulatory agreement terms, this Office also incorporated an adjustment to the financials (reflected in Appendix 1) which adjusts the Developer Overhead based on guidelines issued in November 2005 by the Massachusetts Housing Partnership and Attorney Netter. These guidelines entitled, "Local 40B Review and Decision Guidelines" provide that for a project of similar scope a reasonable level of developer overhead would be \$128,000 or \$80,869 less than what was allowed for the Salisbury Hill Estates development in Appendix 2. We provided these two views of adjustments in order to help the town better understand the issues and the financial impacts. At a more extreme view, the standard regulatory agreements during this timeframe, similar to the draft submitted by Attorney Netter as part of the comprehensive permit application, entirely prohibited developer fees as an allowable development cost.

Land Valuation:

In the cost certification report submitted to CHAPA and audited by Feeley, the developer reported a total land acquisition cost of \$610,000. This is the amount paid for the land, which consisted of three parcels purchased by the Salisbury Hill Corporation on September 4, 2002. Two of these parcels were purchased from Mary L. Carron at a total cost of \$260,000. The third parcel was purchased from John C. and Margaret A. Hobbs for \$350,000. Both sales were contingent upon Salisbury Hill Corporation obtaining a Comprehensive Permit for the construction of not more than 35 townhouse style condominium units on the properties.

The revised and executed regulatory agreement between Salisbury Hill Corporation and Middlesex Federal Savings Bank included substantive changes to the dividend limitation including a clause which defined acceptable site acquisition cost as the cost of site acquisition that can be underwritten by the Project and that can be supported by the subsidizing entity's appraisal upon which its construction loan is based. A land appraisal was conducted as part of the construction loan process that indicated a post permit value based upon the enhanced value of the 40B permit for the site of \$2,270,000. Since the actual acquisition cost of \$610,000 did not exceed this post permit valuation, this Office reflected through Appendix 2 the land cost without any adjustment at \$610,000 which is the same cost which was submitted by the developer to the town in the cost certification.

Similar to the discussion related to Developer Overhead above, it is not clear that the town actually agreed to the terms in the revised and executed regulatory agreement. Therefore, as reflected in Appendix 1, the land value is adjusted to the as-is value under current zoning without any increase that is attributable to the bump-up in value provided by the comprehensive permit. This is in line with the legislative intent and existing guidelines and practices. Based on the work performed by Melanson, an adjustment of \$191,800 was proposed in order to bring the reported land value amount of \$610,000 down to \$418,200 which represents the town's fiscal year 2002 assessed value of the three parcels. This proposed adjustment was made since there was no independent appraisal available for the land prior to the issuance of the comprehensive permit and the contingencies in the purchase and sale agreements reinforced the fact that these transactions were not based on the as-is market value, but rather the purchase and sale agreements were contingent on obtaining a comprehensive permit.

As was previously noted, the program guidelines and practices in effect at the time the revised regulatory agreement was executed called for allowable land acquisition costs to be based on appraised fair market value without a comprehensive permit in place. Any deviation to this requirement would require a waiver from the Director of DHCD. We found no such waiver was ever obtained. This Office finds the attempt by the developer to redefine land acquisition cost to an inflated post comprehensive permit value to be despicable and without merit. This disgraceful effort can only be viewed as an attempt by the developers to unjustly enrich themselves at the

expense of the town and under the guise of affordable housing.

Cost Certification Process Failures:

The cost certification process for the Salisbury Hill Estates development failed to provide a reasonable level of professional skepticism and oversight which one should expect in an audit process. The audited financial statements provided by the developer as part of the cost certification process included costs from unrelated projects and lacked adequate disclosures of pertinent related party transactions. As was previously noted, the principals of the Salisbury Hill Estates development entity were involved in several other projects and costs associated with these other projects were improperly represented by the developer as Salisbury Hill Estates' project costs. This action concealed excess profits from the town. Below market unit sales also were not disclosed by the developer in the cost certification, although the CHAPA review discovered these sales anomalies and properly accounted for them. The developer has an obligation to disclose all significant information appropriately in the financial statements. This lack of full disclosure resulted in misleading financial statements. These misleading financial statements shielded profits that should have been made available for expanding affordable housing initiatives in the town.

Based on the review of the Salisbury Hill Estates project and several other Chapter 40B developments, this Office has uncovered a pervasive abuse by developers of the excess profit determination. The cost certification process has been under the direction of the subsidizing agencies or banks. The business relationship between the subsidizing agencies/banks and the developer stands in the way of effective, meaningful, and independent or arms-length cost monitoring efforts. The lender/customer relationship results in behaviors which run counter to the interests of the municipalities. There is an inherent bias on the part of subsidizing agencies/banks to support their clients (developers) often at the expense of municipalities.

The cost certification process marginalizes the impact of monitoring agents such as CHAPA as these agents are precluded from doing a thorough audit or investigation of the financial transactions. The audits are conducted by "independent" certified public accounting firms which are hired by the developers. This is a fatal flaw in the process which often results in a less than independent determination of the project profits. These developer contracted audits jeopardize the credibility of the limited dividend determination. An independent audit should provide for an open and transparent view of the underlying financial transactions and should not be controlled, managed or influenced by the developer being audited.

The subsidizing agencies have allowed and continue to allow this abuse prone practice of developer commissioned audits. Similar problems arise when the developers select the "independent" appraisers with respect to the land valuation issues. In order to protect the municipality's financial interests, the independent audit and the independent land appraisals should be conducted under the auspices of the

municipality as opposed to the developer or the developer's bankers. At all echelons of government, whether it is at a national, state or local level a government body would not and should not outsource its critical oversight responsibilities to the party being reviewed/audited or to that party's contractors, agents or bankers.

This Office cautions all municipalities in dealing with project cost certifications. Municipalities need to take a proactive role in negotiating, understanding and monitoring excess profits. Unfortunately, subsidizing agencies, rather than taking decisive actions to eradicate the fraud and abuse in the cost certification process have instead put up barriers to effective external oversight by keeping municipalities at bay. As an example, MassHousing recently incorporated an acknowledgement statement in certain regulatory agreements that local ZBA members are asked to sign. This acknowledgement states that the limited dividend requirement is to be determined solely by the project administrator (the bank) and that the regulatory agreement will control over any conflicts with the comprehensive permit. Municipalities and their ZBA's should seriously consider whether they should execute such agreements.

In the case of the Salisbury Hill Estates project, this flawed process has resulted in the developer shielding approximately \$3,000,000 in excess profits from the town. This was done by inflating the expenses for the project, in particular by including costs associated with other projects in the Salisbury Hill Estates financials and also by understating the associated revenues by not disclosing and accounting for below market unit sales. In order to recover the excess profits identified in this report, the town should consider civil action proceedings against all parties involved in the Salisbury Hill Estates development.

Recommendations:

Given the significant difference (approximately +400%) in project profits highlighted through the OIG/Melanson review (79%/70% of total development costs) versus the profit as reported by the developer in his cost certification (13.85% of total development costs) along with an excess profit determination of \$3,064,442/\$2,737,239 versus the developer reported excess profit of zero dollars, this Office makes the following recommendations in order to protect the interests of the town in future 40B developments:

- The town should take a proactive role in the financial aspects of each project. Financial agreements should clearly be memorialized through the comprehensive permit and also preferably through the regulatory agreement. This Office provides the following caution to municipalities regarding regulatory agreements controlled by subsidizing agencies. As previously noted, the subsidizing agencies or banks are not necessarily looking out for the financial interests of the municipalities. The banks have an inherent bias to support their clients (the developers) and often to the detriment of the cities and towns. In order to ensure a fair and accurate accounting of all project profits, municipalities

need to take a leadership role in the cost certification process. Municipalities should not surrender their fiduciary responsibilities to the banks/subsidizing agencies. Rather than correcting the flaws in the oversight process, current and recent changes to the cost certification process promulgated by subsidizing agencies have provided a safe harbor to unscrupulous developers for continued abuse. All municipalities should be cautious and ensure their financial interests are protected.

- This Office strongly recommends that the town insert itself in the cost monitoring process for future projects and may even want to assume the role of monitoring agent. The town should be the principal party in the selection process for the public accounting firm which will perform the detailed cost certification audit and should review the audit procedures to be performed in order to ensure that all concerns are addressed through the audit. These procedures should address independent verification of development costs to ensure that these expenses are reasonable and are actually related to the project. The procedures should also address independent verification of all sales of housing units to ensure arms-length market transactions. All these arrangements should be incorporated in both the comprehensive permit and the regulatory agreement.
- All project agreements such as the regulatory agreement and the comprehensive permit agreement and any changes to these agreements should be reviewed and voted on by the ZBA membership in open meeting. Any approved changes should be documented in the applicable agreements.
- Before issuing a comprehensive permit, the town should validate the allowable acquisition value of the site against pertinent land appraisal(s). The allowable acquisition value should not exceed the as-is fair market value of the site under existing zoning and without the benefit of the comprehensive permit. The appraisals should be compared against the most current real estate tax assessments for the site. Any differences in value greater than 5% should be investigated and resolved. If necessary the town should consider obtaining an independent appraisal of the land. In order to protect both the town and the developer, the determination of the allowable land value to be used in the final cost certification should be memorialized in the comprehensive permit decision.
- As part of the comprehensive permit application process, the developers should identify all planned 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 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 party costs. This includes understanding 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 comprehensive permit and the regulatory agreement should include the requirement that as part of the cost certification, the developer will make available to the town upon request all supporting related party documentation. This should include actual employee labor/payroll records and invoices for all material and subcontractor costs charged to the project. The associated related party overhead and profit should be delineated.

- The town should ensure that included in the project agreements (comprehensive permit and regulatory agreement) are the requirements for a timely cost certification. Looking specifically at the Salisbury Hill Estates project, the CHAPA cost certification report was issued to the town twenty-four (24) months after the last unit was sold in the development. The cost certification process took longer than the project's construction and marketing phases combined. For future projects; the town, the developer and the monitoring agent should agree to a reasonable timeframe for completion of this process. 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 such as escrow deposits. These arrangements should be clearly articulated in the comprehensive permit and the regulatory agreement.

APPENDIX - 1

**SALISBURY HILL ESTATES - FINANCIALS
ADJUSTMENTS BASED ON ORIGINAL DRAFT REGULATORY AGREEMENT**

	<u>Developer Reported Cost Certification</u>	<u>OIG/Melanson Adjustments</u>	<u>OIG/Melanson Adjusted Total</u>
Sales			
Market Rate Units	7,274,929	243,158 (a)	7,518,087
Affordable Units	<u>1,735,873</u>		1,735,873
TOTAL SALES	<u>9,010,802</u>		<u>9,253,960</u>
Construction Costs:			
Building Construction	4,493,506	-323,988 (c) -823,964 (e) -5,400 (n) -665 (o)	3,339,489
Common Costs	1,442,626	-79,390 (m) -82,187 (i) -312,032 (e) -393,312 (k) -8,122 (l) 9,615 (p) -15,000 (q) -111,092 (r)	451,106
Land	610,000	-191,800 (b)	418,200
Subcontractors	<u>316,507</u>	-23,971 (e) -400.00 (f)	292,136
Subtotal	<u>6,862,639</u>		<u>4,500,931</u>
Soft Costs:			
Broker Commission	323,988	-47,300 (d)	276,688
Development Overhead	266,766	-36,574 (e) -9,615 (p) 111,092 (r) 77,286 (r) 25,981 (j) 2,414 (r) -309,350 (t)	128,000
Interest Expense	131,809		131,809
Salaries	107,070	-29,784 (e) -77,286 (r)	0
Legal Fees	55,401	-5,725 (e)	49,676
Consultants	41,450	-38,950 (e)	2,500
Taxes	37,454	-25,981 (j)	11,473
Engineering	29,343		29,343
Licenses and Permits	16,921	-12,043 (e)	4,878
Insurance	10,018	-124 (h)	9,894
Utilities	7,514		7,514
Accounting	6,976		6,976
Telephone	3,821	-3,821 (e)	0
Payroll Expenses	2,414	-2,414 (r)	0
Building Supplies	1,868	-1,868 (e)	0
Postage and Delivery	1,150	-1,150 (e)	0
Office Supplies	1,060	-878 (e)	182
Advertising	108		108
Miscellaneous	7,005	-6,891 (e) -2,154 (g)	-2,040
Subtotal	<u>1,052,136</u>		<u>657,001</u>
TOTAL EXPENSES	7,914,775		5,157,932
Net Profit	1,096,027		4,096,028
Profit as a Percent	13.85%		79.41%
Maximum Allowable Profit (20%)	<u>\$ 1,582,955</u>		<u>\$ 1,031,586</u>
Excess Profit	<u>\$ (486,928)</u>		<u>\$ 3,064,442</u>

See Appendix 3 for Descriptions of Adjustments

APPENDIX - 2

**SALISBURY HILL ESTATES - FINANCIALS
ADJUSTMENTS BASED ON REVISED/EXECUTED REGULATORY AGREEMENT**

	<u>Developer Reported Cost Certification</u>	<u>OIG/Melanson Adjustments</u>	<u>OIG/Melanson Adjusted Total</u>
Sales			
Market Rate Units	7,274,929	243,158 (a)	7,518,087
Affordable Units	<u>1,735,873</u>		1,735,873
TOTAL SALES	<u>9,010,802</u>		<u>9,253,960</u>
Construction Costs:			
Building Construction	4,493,506	-323,988 (c) -823,964 (e) -5,400 (n) -665 (o)	3,339,489
Common Costs	1,442,626	-79,390 (m) -82,187 (i) -312,032 (e) -393,312 (k) -8,122 (l) 9,615 (p) -15,000 (q) -111,092 (r)	451,106
Land	610,000		610,000
Subcontractors	<u>316,507</u>	-23,971 (e) -400.00 (f)	292,136
Subtotal	<u>6,862,639</u>		<u>4,692,731</u>
Soft Costs:			
Broker Commission	323,988	-47,300 (d)	276,688
Development Overhead	266,766	-36,574 (e) -9,615 (p) 111,092 (r) 77,286 (r) 25,981 (j) 2,414 (r) -228,481 (s)	208,869
Interest Expense	131,809		131,809
Salaries	107,070	-29,784 (e) -77,286 (r)	0
Legal Fees	55,401	-5,725 (e)	49,676
Consultants	41,450	-38,950 (e)	2,500
Taxes	37,454	-25,981 (j)	11,473
Engineering	29,343		29,343
Licenses and Permits	16,921	-12,043 (e)	4,878
Insurance	10,018	-124 (h)	9,894
Utilities	7,514		7,514
Accounting	6,976		6,976
Telephone	3,821	-3,821 (e)	0
Payroll Expenses	2,414	-2,414 (r)	0
Building Supplies	1,868	-1,868 (e)	0
Postage and Delivery	1,150	-1,150 (e)	0
Office Supplies	1,060	-878 (e)	182
Advertising	108		108
Miscellaneous	7,005	-6,891 (e) -2,154 (g)	-2,040
Subtotal	<u>1,052,136</u>		<u>737,870</u>
TOTAL EXPENSES	7,914,775		5,430,601
Net Profit	1,096,027		3,823,359
Profit as a Percent	13.85%		70.40%
Maximum Allowable Profit (20%)	\$ <u>1,582,955</u>		\$ <u>1,086,120</u>
Excess Profit	\$ <u>(486,928)</u>		\$ <u>2,737,239</u>

See Appendix 3 for Descriptions of Adjustments

Appendix – 3

Salisbury Hill Estates – Financials Adjustment Descriptions

- (a) To adjust for unit sales at below market prices
- (b) To reflect the land value at the as-is value under current zoning without the benefit of the comprehensive permit
- (c) To adjust for the apparent double counting of commissions expense
- (d) To adjust for brokers commissions on affordable units which was not paid
- (e) To adjust for costs associated with other projects and for which no supporting documentation was provided
- (f) To adjust for costs not related to the Salisbury Hill Estates development
- (g) To adjust for costs reported in excess of general ledger expenses
- (h) To adjust for payment made in excess of invoice amount
- (i) To adjust for reclass entry made with no back-up support
- (j) To reclassify tax related costs to development overhead account
- (k) To adjust for JE#17 made by developer with no back-up support provided
- (l) To adjust for interest payments related to the Brown Street project in Tewksbury
- (m) To adjust for ADJ DTJ which represent cost associated with a different project
- (n) To adjust for duplicate payments
- (o) To adjust for other non project related costs improperly reflected as Salisbury Hill Estates costs
- (p) To reclassify payments made to the town of Billerica as common costs
- (q) To adjust for payments made to Rocco Scippa with no back-up provided
- (r) To reclassify payments made to DWW principals as developer overhead expense
- (s) To adjust developer overhead to 4% of total adjusted development costs
- (t) To adjust developer overhead to conform to MHP November 2005 guidelines

OFFICE OF THE INSPECTOR GENERAL

**Agreed Upon Procedures
Schedules of Chapter 40B Maximum
Allowable Profit from Sales and Total
Chapter 40B Project Costs**

**Salisbury Hill Estates
81 Salem Road
Billerica, Massachusetts**

DRAFT

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

Dear Mr. Sullivan,

We have performed the procedures outlined in the following report, which were agreed to by the Office of the Inspector General (OIG), solely to assist the specified parties in an investigation of possible misstatements in the *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs* filed by certain developers.

The work was performed on documents summonsed by the OIG. The documentation included, but was not limited to:

- Project eligibility/site approval.
- Comprehensive Permit including financial pro forma, overhead limitations, and original land appraisal.
- Monitoring Service Agreements and amendments.
- Annual Compliance Report provided to the Zoning Enforcement Officer of the municipality.
- Audited *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs*.
- Copy of review report of audited *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs* done at request of monitoring agency.
- Detailed general ledger of developer (hard copy and electronic).
- Supporting documentation for developer expenses including invoices, canceled checks, timesheets, and commission agreements.
- Supporting documentation for any adjusting journal entries including methodology for any allocations.
- A list, with name, address and phone number, of all vendors paid, with identified related parties noted.
- A schedule of sales prices for all units.
- Federal and State tax filings for the developer.

The agreed upon procedures were performed in accordance with the attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified parties

in this report. Consequently, we make no representations regarding the sufficiency of the procedures for the purpose for which this report has been requested or for any other purposes.

We were not engaged to, and did not, conduct an examination, the objective of which would be an expression of an opinion on the *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs*. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that would have been reported to you.

Included in the report is background information on the project, the results of the agreed upon procedures performed, a schedule of proposed adjustments to the project revenues and costs based on the results, and a proposed recalculation of the net profit for the project.

This report is intended solely for the information and use of the OIG. However, the report is a public document and its distribution is not limited.

June 5, 2006
Andover, Massachusetts

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BACKGROUND

Salisbury Hill Corporation, a domestic profit corporation, was created for the development of 44 residential condominium units in Salisbury Hill Estates, located at 81 Salem Road in Billerica, Massachusetts. Eleven units were designated to be affordable housing and sold for \$ 157,500 each. The remaining units were sold for between \$ 1 and \$ 229,900 each. Purchase and sale agreements for the land were executed with two outside parties in February and March 2001. Both agreements were contingent on obtaining a Comprehensive Permit, which was approved on May 1, 2002. The last unit was sold on March 12, 2004.

PROCEDURES AND RESULTS

1. We reconciled expenses reported on the *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs* to the developer's general ledger.

Results:

The *Schedule of Total Chapter 40B Project Costs* reported expenses \$ 2,154 greater than the total costs recorded in the general ledger. We recorded an adjustment for this variance. [See Appendix I (11).]

In addition to the variance noted above, we noted some reclassifications for the amount reported, including rokerage commissions which had been reclassified from building construction costs in the general ledger. See Section 7, Brokerage Commissions Market Rate Units for further discussion of this issue.

2. We reviewed all journal entries in the developer's general ledger for the purpose of determining if the entry had a sound accounting basis and appropriate back-up.

Results:

Journal entries were used to record all payroll entries and bank deposits which resulted in an appropriately large number of journal entries. Additional expected entries were for such purposes as moving construction costs from inventory accounts to costs of good sold, and recording the sales of the units.

We noted that the sales of units to the corporation principals were recorded in the general ledger as a sale and a distribution to the individual. This would be the appropriate accounting entry for these transactions.

We noted that a number of journal entries were recorded to the account for the cost of land. For reporting purposes, the land was reported at acquisition cost and the remaining expenses journaled into the account appear to have been appropriately reported as common costs.

3. We reviewed back-up documentation for all expenses by the developer for the purpose of determining if back-up was sufficient to support the conclusion that the cost was incurred as part of the identified 40B project.

Results:

We identified:

- \$ 251,373 in related party expenses for which no back-up documentation was provided. See Section 4, Related Parties for further discussion of this issue.
 - Nineteen instances, totaling \$ 130,677, where documentation was insufficient to verify the cost was project related.
 - One instance of a duplicate payment for \$ 5,400.
 - One instance of a \$ 665 cost that was not project related.
 - One instance where payment was in excess of the invoice by \$ 124.
 - Numerous instances, totaling \$ 858,404, where the only documentation was a check stub or a general ledger entry indicating a check had been issued.
 - For Moore's Lumber, we had both instances of payment without back-up documentation and instances of valid invoices for which we could not determine the check on which payment was made. Supported costs without check number were netted against the checks with unsupported expenses and we recorded an adjustment of \$ 266,358 for costs that were not supported by an invoice.
4. For expenses to related parties, we verified that the costs were consistent with industry averages, did not represent goods or services which were also obtained through a non-related party vendor, and were for expected goods or services needed to complete the project.

Results:

We identified payments to three related party entities:

- a. Dresser, Williams and Way, Inc. (also known as Raymond Engineering).

As noted in the *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs*, as well as the cost certification review done by CHAPA, payments to Dresser, Williams, and Way, Inc. totaled \$ 476,320, \$ 54,000 of which was a loan repayment for net vendor payments of \$ 422,320.

We were provided with a number of invoices from both Raymond Engineering and Dresser, Williams and Way, Inc (DWW). Invoices from both companies had addresses of 36 Webb Brook Road and 574 Boston Post Road. As of September 13, 2002, \$ 206,576 had been paid for services rendered. Support documentation for these payments consisted of two invoices totaling \$ 206,383. Both invoices were Invoice # 1020. One invoice for \$ 102,431, from Raymond Engineering, included detailed information on hours worked, by individual, for the period from October 2000 to September 3, 2002. The second invoice, for \$ 103,952, was from DWW. We noted several concerns with the second invoice. First, it is the only DWW invoice dated before February 28, 2003, at which point all invoices changed from Raymond Engineering to DWW. Secondly, the address on this invoice was 36 Webb Brook Rd. All other invoices, from both vendors, dated prior to December 4, 2003 had the 574 Boston Post Road address. Finally, there was no back-up documentation as to hours, dates, or worked performed with the DWW invoice. As a result of these concerns, we question the validity of the second invoice.

Without inclusion of the questioned DWW invoice, total costs invoiced were \$ 345,645. The costs were broken down as follows: \$ 37,232 for professional fees and office administration, \$ 79,482 for miscellaneous engineering, and \$ 228,931 documented by hours worked. This is \$ 89,878 less than the amount paid. See Section 6, Overhead, Management, and General Profits for additional discussion of the payments to DWW.

b. Rocco Scippa

It is our understanding that Rocco Scippa was the general contractor for the project. He was paid \$ 427,000. Of the amount paid, \$ 400,000 was recorded as commissions and does not appear to have been reported on the *Schedule of Total Chapter 40B Project Costs*, \$ 15,000 was reported as a common cost and \$ 12,000 was reported as development overhead. We were not provided back-up documentation for any of these payments and we recorded a \$ 15,000 adjustment to costs. [See Appendix I (1).]

c. J.J Phelan and Sons Co., Inc.

J.J. Phelan and Sons Co., Inc was paid \$ 752,058.

- \$ 223,938 was recorded in the general ledger as excavation costs, and was reported on the *Schedule of Total Chapter 40B Project Costs* as Other Subcontractors. \$ 100,000 of this total was not supported by any documentation and we recorded an adjustment to costs. [See Appendix I (1).]
- \$ 100,000, recorded as commissions in the general ledger, was not supported by an invoice and was not reported on the *Schedule of Total Chapter 40B Project Costs*. We did not record an adjustment.
- \$ 428,120 was recorded in the general ledger and reported as Common Costs. \$ 46,495 of that amount was not supported by invoices or other documentation and we recorded an adjustment to costs. [See Appendix I (1).]

As a result, total adjusted costs reported as paid to J.J. Phelan were \$605,563.

5. We verified that the cost of land reported for the project was the As-Is Market Value, excluding any value relating to the possible issuance of the Comprehensive Permit, by comparing the cost to the original independent appraisal.

Results:

The developer reported a total land acquisition cost of \$ 610,000. This is the amount paid for the land, which consisted of three parcels purchased by the Salisbury Hill Corporation (buyer) on September 4, 2002. Two of these parcels were purchased from Mary L. Carron at a total cost of \$ 260,000. The third parcel was purchased from John C. and Margaret A. Hobbs for \$ 350,000. Both sales were contingent upon the buyer obtaining a Comprehensive Permit for the construction of not more than 35 townhouse style condominium units on the properties. Per the OIG, the fiscal year 2002 assessed value of the three parcels totaled \$ 418,200. Since the purchase prices for the land included the Comprehensive Permit approval contingency, we recorded an adjustment of \$ 191,800 to reflect the land's assessed value of \$ 418,200 at the time of its purchase. [See Appendix I (13).]

6. We verified any overhead, management, and general profit costs included in the expenses reported, and verified that the percents were within limits established during the approval process, as well as available guidelines such as the *Local 40B Review and Decisions Guidelines* prepared by the Massachusetts Housing Partnership.

Results:

Of the \$ 266,766 reported as Development Overhead, \$ 218,576 was for payments made to DWW. The additional \$ 203,744 paid to DWW was

recorded and reported as Common Costs, Engineering, and Equipment Rental. As noted in Section 4, Related Parties, we did an analysis of the invoices submitted by Raymond Engineering and DWW. We would consider the \$ 37,232 paid as office administration and professional fees as well as the \$ 89,878 not supported by invoices to be part of development overhead. The remaining \$ 91,466 of the \$ 218,576 reported as Development Overhead is 40% of the \$ 228,931 paid that was supported by time reports at hourly rates. The nature of the time descriptions included attending closings, which would be part of development overhead, as well as site visits that would more likely be actual engineering costs. We did not have sufficient evidence to support the need for an adjustment to the amount reported as Development Overhead.

We also noted that the amount reported included \$ 7,923 in payments to the Town of Billerica that we reclassified to Common Costs. [See Appendix I (12).]

The Comprehensive Permit limited the development overhead to 4% of total costs, which would be \$ 224,826. As a result, we recorded an adjustment of \$ 34,017 to development overhead. [See Appendix I (10).]

7. We verified that any commissions on the sales of market units did not exceed 6%, or 5% if there was an identified interest between the development entity and the brokerage agency. We verified that all advertising costs were included within the commissions paid.

Results:

Brokerage commissions reported, of \$323,988 were less than 5% of the actual total sales price for the market rate units of \$ 6,506,144. The total sales price for the market rate units is \$ 768,785 lower than the amount reported on the *Schedule of Chapter 40B Maximum Allowable Profit from Sales*. This variance is the result of the developer appropriately reporting the market rate sales prices for three units, sold to project principals for \$ 1, and one unit, sold to American Dream Realty Trust, for \$ 85,000 less than the market rate.

However, we did not have copies of the HUD settlement statements to verify actual amounts paid for each unit. We were provided a document noting that 10 market rate units were excluded from compensation, at a rate of 4% of sales price, or \$ 90,960, being paid by Salisbury Hill Corporation to American Dream Homes, Inc. There were no vendor payments to American Dream Homes, Inc. and we were unable to identify journal entries recording commission expense as part of the sales of units. We did note that one unit was sold to American Dream Realty Trust for \$ 138,940, which was considerably less than the next lowest market rate price of \$ 224,900.

We noted that at the same time entries were recorded for the sale of the units to the principals, \$ 85,000 was added to "Other Income" with the offset entry to Deposits Unit 21. Unit 21 was the unit sold to American Dream Realty Trust and the entry resulted in a sale price of \$ 223,940, which is market rate. The particular unit was resold 15 months later for \$ 306,000, a gross profit of \$ 167,060. We calculate the commission due for the remaining 23 market rate units, at a 4% rate, would have been \$ 158,888.

We also identified payments to individuals, some noted as commissions, at a rate of 4% of sales price for the units that were recorded as part of the building construction costs. As a result, we recorded a reclassification with building construction costs of \$ 63,742 to reduce brokerage commissions on market rate units to 4% of sales. [See Appendix I (9).]

8. We verified that the fee for marketing and lottery costs for the affordable units did not exceed the greater of \$ 20,000, or 3% of the sum of actual affordable unit sales prices.

Results:

We calculated 3% of the actual affordable unit sales price, of \$ 1,732,500, to be \$ 51,975. We identified payments of \$ 3,029 to the lottery agent, Billerica Housing Authority, and \$ 108 to rent the hall for the lottery. As a result, no adjustment was recorded.

9. We reconciled the total sales revenue, per the schedule provided by the OIG, to the revenues reported in the general ledger and as reported in the *Schedule of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs*.

Results:

Total sales revenue, as reported, agreed to the general ledger and was \$ 772,158 higher than the total per the unit sales schedule provided by the OIG. Of this amount, \$ 768,785 was the result of the developer appropriately reporting the market rate sales price for three units sold to principals for \$1 and one unit sold to American Dream Realty Trust for \$ 85,000 less than market rate. We were unable to identify the remaining variance of \$ 3,373 between the sales revenue reported for the affordable units and the amount reported on the schedule provided by the OIG.

In addition to the four market units sold to the corporation principals and American Dream Realty Trust, Unit 111 was sold to Mary Carron, a former property owner, for \$ 1. We did not find evidence that this sale was reported at market rate, so we recorded an adjustment of \$ 224,899 to the sales reported. [See Appendix I (2)].

10. We reviewed tax filings for the developer LLC for the purpose of determining that revenues and expenses reported on the cost certification statements agree to reported taxable amounts passed through to the owners of the LLC.

Results:

Total expenses as reported on the tax returns is higher than the amount reported on the *Schedules of Chapter 40B Maximum Allowable Profit from Sales and Total Chapter 40B Project Costs* by \$ 63,713. As a result, the net profit on the tax return is \$ 63,713 lower. We did not have sufficient information to verify if the variance was the result of appropriate differences in book and tax income.

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CONCLUSION

The identified adjustments are summarized in Appendix I. The net effect of the adjustments is that net profits exceeded the maximum allowable 20% by \$ 1,764,251.

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APPENDIX I

**Summary Schedule of
Adjusted Revenues and Expenses Reported**

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Salisbury Hill Estates
Billerica, Massachusetts
Summary Schedule of Adjusted Revenues and Expenses Reported

	<u>Reported</u>	<u>Adjustments</u>	<u>Adj. Amount</u>
Sales			
Market Rate Units	7,274,929	224,899 (2)	7,499,828
Affordable Units	<u>1,735,873</u>		<u>1,735,873</u>
TOTAL SALES	<u>9,010,802</u>		<u>9,235,701</u>
Construction Costs:			
Building Construction	4,493,506	(130,328) (3) (5,400) (4) (665) (5) (583,622) (6) 63,742 (9) (266,358) (8)	3,570,875
Common Costs	1,442,626	(161,495) (1) (349) (3) (140,325) (6) 7,923 (12)	1,148,380
Land	610,000	(191,800) (13)	418,200
Subcontractors	<u>316,507</u>	(88,269) (6)	<u>228,238</u>
Subtotal	<u>6,862,639</u>		<u>5,365,693</u>
Soft Costs:			
Broker Commission	323,988	(63,742) (9)	260,246
Development Overhead	266,766	(34,017) (10) (7,923) (12)	224,826
Interest Expense	131,809		131,809
Salaries	107,070	(23,078) (6)	83,992
Legal Fees	55,401		55,401
Consultants	41,450	(2,190) (6)	39,260
Taxes	37,454	(10) (6)	37,444
Engineering	29,343		29,343
Licenses and Permits	16,921	(11,130) (6)	5,791
Insurance	10,018	(9,780) (6) (124) (7)	114
Utilities	7,514	-	7,514
Accounting	6,976	-	6,976
Telephone	3,821	-	3,821
Payroll Expenses	2,414	-	2,414
Building Supplies	1,868	-	1,868
Postage and Delivery	1,150	-	1,150
Office Supplies	1,060	-	1,060
Advertising	108	-	108
Miscellaneous	7,005	(2,154) (11)	4,851
Subtotal	<u>1,052,136</u>		<u>897,988</u>
TOTAL EXPENSES	<u>\$ 7,914,775</u>	<u>(1,426,195)</u>	<u>\$ 6,263,681</u>
Net Profit	1,096,027		2,972,020
Expenses Adjusted for Overhead			6,038,847
Profit as a Percent	13.85%		49.22%
Maximum Allowable Profit (20%)	<u>1,582,955</u>		<u>1,207,769</u>
Excess Profit	<u>\$ (486,928)</u>		<u>\$ 1,764,251</u>

- (1) Adjust for payments to related parties with no support documentation.
- (2) To adjust the sales price of one unit to former land owner to market rate.
- (3) Nineteen instances where documentation was insufficient to verify cost was project related.
- (4) One instance of a duplicate payment.
- (5) One instance of a cost that was not project related.
- (6) Adjust for costs documented only by evidence that the check was issued.
- (7) One instance of payment in excess of the invoice.
- (8) To adjust costs reported for Moore's Lumber to the invoices provided.
- (9) Reclass 1% of total brokerage commissions to cost of goods sold to reflect a commission rate of 4% actually paid.
- (10) Adjust for overhead in excess of allowable 4% of adjusted costs.
- (11) Adjust for costs reported in excess of general ledger expenses.
- (12) Reclassify payments to the Town of Billerica as Common Costs.
- (13) Adjust land value to assessed value.



The Commonwealth of Massachusetts
Office of the Inspector General

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August 22, 2007

Edith Netter, Esq.
Edith M. Netter & Associates, P.C.
375 Totten Pond Road
Waltham, MA 02451

Dear Attorney Netter:

This Office is in the process of preparing the final report to the town of Billerica regarding our review of the limited dividend for the Salisbury Hill Estates housing development built under Chapter 40B by your client, Mr. Stephen Dresser/Salisbury Hill Corporation. Enclosed is a copy of the draft audit report prepared by Melanson Heath & Company, PC (Melanson). Also enclosed is an updated worksheet reflecting this Office's adjustments to the financial statements previously reported by your client to the town of Billerica. These adjustments were determined based on the Melanson audit and subsequent work performed by this Office including review of additional documents provided by your client.

We have determined through review of the documentation provided by your client and the related adjustments that the Salisbury Hill Estates development generated profits well in excess of the 20% cap limit. Your client originally provided a cost certification statement reflecting total sales for the project at \$9,010,802 and total expenses at \$7,914,775 resulting in a net profit of \$1,098,027; or 13.85% of total expenses with no excess profit. This Office has determined that the reported sales were understated by \$243,158 and that the total expenses were overstated by \$2,705,775. Based on these determinations the net profit for the project is \$4,044,960 or 77.65% of total expenses and results in an excess profit owed to the town of \$3,003,160.

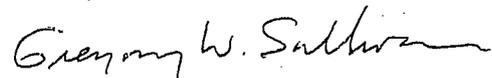
The largest adjustment (\$1,310,391) is for expenses charged to the project for which no supporting documentation has been provided to this Office. Based on alternative analytical procedures, it appears that many of these unsupported expenses are not related to the Salisbury Hill Estates project but are associated with other projects undertaken by the developer (Salisbury Hill Corporation).

Edith Netter
August 22, 2007
Page 2 of 2

Please contact my office (617-727-9140) by September 5, 2007 if you have any questions or concerns as we plan to provide copies of the Melanson draft report and the enclosed adjustment worksheet along with our final report to the town of Billerica by mid September.

This office thanks you and Mr. Dresser for the support and cooperation you extended to the audit team. We believe that the results of this audit will help improve the Chapter 40B oversight process which in turn will help affordable housing initiatives throughout the commonwealth.

Sincerely,



Gregory W. Sullivan
Inspector General

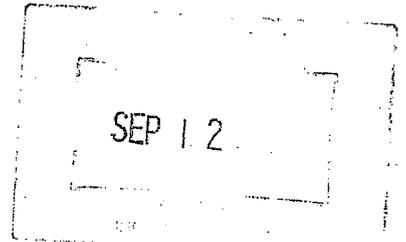
Cc: Mr. Stephen Dresser

SALISBURY ESTATES

	<u>Reported</u>	<u>Adjustments</u>	<u>Adj. Amount</u>
Sales			
Market Rate Units	7,274,929	243,158 (a)	7,518,087
Affordable Units	<u>1,735,873</u>		1,735,873
TOTAL SALES	<u>9,010,802</u>		<u>9,253,960</u>
Construction Costs:			
Building Construction	4,493,506	-323,988 (c) -823,964 (e) -5,400 (n) -665 (o)	3,339,489
Common Costs	1,442,626	-79,390 (m) -82,187 (i) -312,032 (e) -393,312 (k) -8,122 (l) 7,923 (p) -15,000 (q) -111,092 (c)	449,414
Land	610,000	-191,800 (b)	418,200
Subcontractors	<u>316,507</u>	-23,971 (e) -400.00 (f)	292,136
Subtotal	<u>6,862,639</u>		<u>4,499,239</u>
Soft Costs:			
Broker Commission	323,988	-69,300 (d)	254,688
Development Overhead	266,766	-49,314 (e) -7,923 (p) 111,092 (c) 77,286 (c) -197,561 (s)	200,346
Interest Expense	131,809		131,809
Salaries	107,070	-29,784 (e) -77,286 (c)	0
Legal Fees	55,401	-5,725 (e)	49,676
Consultants	41,450	-38,950 (e)	2,500
Taxes	37,454	-25,981 (j)	11,473
Engineering	29,343		29,343
Licenses and Permits	16,921	-12,043 (e)	4,878
Insurance	10,018	-124 (h)	9,894
Utilities	7,514		7,514
Accounting	6,976		6,976
Telephone	3,821	-3,821 (e)	0
Payroll Expenses	2,414		2,414
Building Supplies	1,868	-1,868 (e)	0
Postage and Delivery	1,150	-1,150 (e)	0
Office Supplies	1,060	-878 (e)	182
Advertising	108		108
Miscellaneous	7,005	-6,891 (e) -2,154 (g)	-2,040
Subtotal	<u>1,052,136</u>		<u>709,761</u>
TOTAL EXPENSES	7,914,775		5,209,000
Net Profit	1,096,027		4,044,960
Profit as a Percent	13.85%		77.65%
Maximum Allowable Profit (20%)	<u>\$ 1,582,955</u>		<u>\$ 1,041,800</u>
Excess Profit	\$ (486,928)		\$ 3,003,160

- (a) Adjust for sales at below market prices
- (b) Adjust Land value to assessed value
- (c) Adjust for double counting of commissions expense
- (d) Adjust for commissions reflected against affordable units
- (e) No supporting documentation provided
- (f) Costs related to different project
- (g) Melanson Adjustment for costs reported in excess of general ledger expenses
- (h) Melanson Adjustment for one instance where payment was in excess of invoice
- (i) Adjust for Reclass B entry with no backup support
- (j) Non project related tax expenditures
- (k) Adjust for JE#17 with no backup support
- (l) Middlesex Payments for Brown Street
- (m) Adjust for ADJ DTJ - These costs relate to another development
- (n) Melanson Adjustment for duplicate payment
- (o) Melanson Adjustment for cost that was not project related
- (p) Melanson Adjustment reclassifying payments to the town of Billerica as Common Costs
- (q) Unsupported payment made to Rocco Scippa
- ⊗ Reclass adjustment to book related party (DWWW) principal's costs to developer overhead
- (s) Adjust Developer Overhead to 4% of total development costs

Edith M. Netter  *Associates, P.C.*



Land Use Law
Environmental Law
Mediation
Consensus Building

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Massachusetts 02451
781 290 0505
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By overnight mail
September 11, 2007

Gregory W. Sullivan, Inspector General
State Office Building
One Ashburton Place, Room 1311
Boston, MA 02108

Re: Salisbury Hill Estates

Dear Mr. Sullivan:

We are in receipt of your letter dated August 22, 2007. Salisbury Hill Corporation is not able to comment at this time without your providing to my client a detailed explanation of the \$1,238,909 discrepancy between your letter (and the accompanying worksheet) and the draft Melanson audit report and your letter and whatever document provided the basis for the comparison.

We do not know to which "financial statements reported by my client to the town of Billerica" you were referring. As you know, my client submitted a certified cost and income statement prepared by Feeley and Driscoll, Certified Public Accountants to CHAPA for its review, as required by the regulatory agreement signed by the town of Billerica and my client. Is this the "statement" to which you were referring or was it one of the pro formas submitted by my client to the Billerica Zoning Board of Appeals? We also do not know why and how these "statements" were adjusted. All we have is a set of numbers, the basis for which is unclear.

In sum, we would appreciate it if you would send a detailed statement explaining the basis for the adjustments and which financial statements were adjusted. We would then have a basis for reviewing your letter.

Thank you for the opportunity to respond. Please note that I will be out of the country from September 15 through 25th. I would appreciate having some time to review your response with my client and consider my client's response to any new information that you provide, prior to the time that you send your letter to the town of Billerica.

Sincerely,

Edith M. Netter

cc: Stephen Dresser



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

September 25, 2007

Edith Netter, Esq.
Edith M. Netter & Associates, P.C.
375 Totten Pond Road
Waltham, MA 02451

Dear Attorney Netter:

In response to your request, highlighted below are clarifying details explaining the basis for this Office's proposed adjustments to the Salisbury Hill Estates cost certification. Hopefully, this will help facilitate your review. The expectation is that your client will respond with any additional illuminating information by Tuesday, October 9, 2007. We plan to provide our findings to the town of Billerica during the week of October 15, 2007. We will make changes to our proposed adjustments based on instructive information provided by your client. We'll incorporate your client's responses in our communication to the town.

This Office used the certified cost and income statement (audited by Feeley & Driscoll, Certified Public Accountant dated August 12, 2005) provided by your client to CHAPA as the baseline for all our proposed adjustments. The first column in the worksheet previously provided reflects the income and expense as reported to CHAPA by Salisbury Hill Corporation. The second column contains our proposed adjustments and the third column represents the recalculated project financials after consideration of the proposed adjustments.

The cost certification provided by your client to CHAPA reflected total sales of \$9,010,802 and total development costs of \$7,914,775 with an associated profit of \$1,096,027 or 13.8% of total development costs (see column 1). Our adjustments (column 2) reflect an increase of \$243,158 to the reported sales and a net decrease of \$2,705,775 to reported project costs. The adjusted sales total \$9,253,960 and the adjusted development costs equal \$5,209,000 resulting in an adjusted profit of \$4,044,960 or 77.65% of adjusted development costs. This in turn results in an excess profit of \$3,003,160 for the project.

Adjustment Details:

- An adjustment (adjustment (a)) totaling \$243,158 was made to sales to reflect the underreported sales revenue associated with the below market sales of Unit 111 (Mary Carron) and Unit 21 (Charlene McCarthy). This revenue adjustment is consistent with the adjustment identified through the CHAPA cost monitoring review.
- On the cost side of the ledger the largest single adjustment (adjustment (e)) totals \$1,310,391. This adjustment was made since the developer has not provided the associated documentation supporting these costs. Details of these unsupported costs have been provided to your client several months ago.
- The land acquisition cost was adjusted (adjustment (b)) down by \$191,800 to the tax assessed value of \$418,200. In our opinion the tax assessed value is more reflective of the as-is market value of the land, and excludes any value associated with the issuance of a comprehensive permit. The cost certification submitted by the developer reflects the actual acquisition cost of \$610,000. This acquisition was contingent upon the developer obtaining a comprehensive permit.
- Under soft costs in the cost certification report, the developer reflects \$323,988 as Broker Commissions. This same cost was charged to Building Construction in the developer's general ledger. Our adjustment (adjustment (c)) of \$323,988 reducing the Building Construction costs by \$323,988 was made to correct for this apparent doubling of expense. We understand that a reclassification entry may have been made by your client that would correct for this apparent double counting of expense, but we were not provided with any back-up support.
- The Broker Commission costs include \$69,300 related to the affordable units. Our adjustment (adjustment (d)) eliminated this as an allowable development cost since we were not initially provided with supporting back-up. Based on supplemental information received through the broker, we plan to reinstate \$22,000 of this expense since the broker actually received \$2,000 (not \$6,300) for each of the 11 affordable units sold.
- The majority of the journal entries appeared to be valid and appropriate for this project. There were, however, two journal entries which we questioned and requested the supporting back-up documentation. This back-up support was not provided and we therefore made adjustments (adjustment (i) for \$82,187 and adjustment (k) for \$393,312) to the developer submitted cost certification report for these unsupported journal entries.
- Reflected in the cost certification report were costs associated with the Brown Street project in Tewksbury. Adjustment (l) for \$8,122 and adjustment (m) for \$79,390 were made to account for these non Salisbury Hill Estates project costs.

Adjustment (l) is related to interest payments made on behalf of the Brown Street project and Adjustment (m) eliminates the adjusting entry (ADJ DTJ) made on December 31, 2004 which was booked against the Salisbury Hill Estates project but is actually for the benefit of Jasmine Development, LLC which is the developer of the Brown Street project.

- In addition to the other unsupported costs, we made an adjustment (adjustment (q)) for the \$15,000 paid to Rocco Scippa, a related party in the development for which we were not provided with back-up support.
- Two of the adjustments represent a reclassification of expenses and not a disallowance. These include; adjustment (p) which transfers \$7,923 of payments for police details made to the town of Billerica from the Development Overhead account to the Common Costs account; and adjustment (r) which transfers into development overhead \$111,092 from Common Costs and \$77,286 from the Salaries account. These costs reflect direct expenses of the developer in administering and managing the Salisbury Hill Estates project.
- Included under the Taxes account was \$25,981 in payments to the Commonwealth of Massachusetts for S Corporation Excise Tax. Since this cost is not directly related to the Salisbury Hill Estates housing development we made an eliminating entry (adjustment (j)). On further review this adjustment should be a reclassification (not elimination) to Development Overhead. We plan to make the appropriate change in the final report.
- Developer Overhead was modified through adjustment (s) for \$197,561. This brought the allowable developer overhead to the prescribed 4% of total development costs.
- Other cost adjustments include; a \$5,400 reduction (adjustment (m)) to Building Construction due to duplicate payments; a reduction of \$2,154 (adjustment (g)) to Miscellaneous expense to adjust for the variance between total costs reflected in the general ledger versus the higher total reported through the developer's cost certification; a reduction totaling \$1,065 (adjustments (f) & (o)) for non-project related expenses charged to the Salisbury Hills development; and a reduction of \$124 (adjustment (h)) for an insurance payment in excess of the invoice amount.

Please contact my office (617-727-9140) if you have any questions or concerns.

Sincerely,



Gregory W. Sullivan
Inspector General

CC: Mr. Stephen Dresser.

Edith M. Netter  *Associates, P.C.*

By email to Attorney Hansberry and by first class mail to the Inspector General

October 9, 2007

Land Use Law
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Gregory W. Sullivan, Inspector General
Office of the Inspector General
State Office Building
One Ashburton Place, Room 1311
Boston, MA 02108

Re: Salisbury Hill Estates

Dear Mr. Sullivan:

Please be advised that we were not able to provide new information in response to your letter dated September 25, 2007. This is largely because you did not, as requested, outline the basis for the very substantial adjustments that your office made to the Melanson report. You simply noted that your changes were based on "subsequent work performed by this Office including review of additional documents provided by your client." Also, you did not provide us with a list or even a summary of those expenditures for which you said we provided checks but no invoices. If my client had this information he could have done an additional review of the records to see whether he could locate the documentation that you said was missing.

Sincerely,

Edith M. Netter

cc: Client



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
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October 15, 2007 .

Edith M. Netter, Esq.
Edith M. Netter & Associates, P.C.
375 Totten Pond Road, Suite 102
Waltham, MA 02451

Dear Attorney Netter:

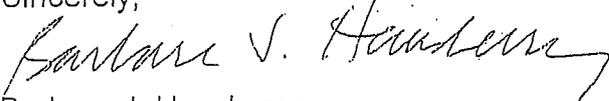
I received your email after business hours on October 9, 2007, the date that we had previously agreed your documents were due.

On July 26, 2006 you wrote a memo to me committing your client to produce backup documents for approximately \$2.9 million in expenditures for the Salisbury Hill Eastern project. The 18-page listing of the missing documents was provided to you by this Office which you attached to the July 26th memo. To date, you have provided to this Office approximately \$200,000 worth of supporting documentation for the above expenditures.

In our September 25, 2007 letter, we stated that the largest single adjustment made by this Office to your client's certified costs statement was made because your client has not provided additional supporting documents for the above \$2.9 million in expenditures. As you can see, the back-up for these expenditures has been outstanding to this Office for over 1 year. Your claim in this morning's email that we have not outlined the basis for the adjustment is simply unfounded.

The Inspector General's report will explain that after providing ample (over 1 year) time to your client, he has not produced any additional supporting documents to validate expenditures approximating \$2.7 million.

Sincerely,


Barbara J. Hansberry
General Counsel