

**PREPARATION OF COST CERTIFICATION UPON COMPLETION OF HOMEOWNERSHIP
40B PROJECT FOR WHICH MASSHOUSING SERVES AS PROJECT ADMINISTRATOR**

Guidance to Developers and Municipalities

I. Introduction

Outlined below are the procedures relating to the preparation and submission of the cost certifications which must be provided to the Massachusetts Housing Finance Agency (“MassHousing”) by developers upon the completion of comprehensive permit (Chapter 40B) projects for which MassHousing is Project Administrator pursuant to the *Guidelines for Housing Programs in Which Funding is Provided Through a Non-Governmental Entity* (the “NEF Guidelines”) issued by the Department of Housing and Community Development (“DHCD”). Such cost certifications must be examined in accordance with the attestation standards established by the American Institute of Certified Public Accountants (“AICPA”). The purpose of requiring an examination of the cost certification in accordance with the AICPA attestation standards is to assist the Project Administrator in determining whether the developer has complied with the applicable profit limitation for the project under Chapter 40B and the NEF Guidelines. Also outlined below are the procedures relating to the Project Administrator’s analysis of the cost certification. The objective of these instructions is to provide clear guidance to developers, accountants and municipalities about how determination of the developer’s compliance with the limited dividend requirement under Chapter 40B shall be made.

II. Summary of Process

The developer’s cost certification shall be examined in accordance with the AICPA attestation standards by an independent certified public accountant (the “Developer’s CPA”). Developers should provide the cost certification to the Developer’s CPA using the format of the schedules attached hereto. The submission shall include (i) a Schedule of Total Chapter 40B Maximum Allowable Profit from Sales, (ii) a Schedule of Total Chapter 40B Project Costs, (iii) a Developer’s Certificate, including Exhibit A, Disclosure of Related Party Transactions, and Exhibit B, Identification of Appropriate RS Means Construction Data, and Exhibit C, Release authorizing the Developer’s CPA to share its work papers and other supporting documentation with the Project Administrator and/or its agent and the Municipality [provided this Release has not been previously delivered], (iv) a General Contractor’s Certificate, and (v) any other information required by the Developer’s CPA in order for the Developer’s CPA to be able to issue its report. It is the duty of the developer to provide or cause others to provide any and all information needed for the Developer’s CPA to perform an examination in accordance with the AICPA attestation standards.

The Developer’s CPA shall use the Examination Program (Parts A through G) attached hereto.

In performing its examination under the AICPA attestation standards, the Developer's CPA should follow the Program attached as an exhibit to this document. At the conclusion of its examination under the AICPA attestation standards, the Developer's CPA shall issue an Independent Accountant's Report in the form attached hereto, stating that its examination was performed in accordance with AICPA attestation standards and that the attached schedules were prepared on the basis of accounting and reporting practices prescribed by MassHousing, as the Project Administrator acting on behalf of DHCD under the NEF Guidelines. The accounting and reporting practices prescribed by the Project Administrator for the preparation of the project cost certifications are outlined in the specific instructions provided below.

The cost certification which has been examined in accordance with the AICPA attestation standards and has been submitted by the developer shall be analyzed by the Project Administrator. This analysis may result in questions being asked and clarifications being requested by the Project Administrator of the developer and/or the Developer's CPA. As part of its analysis, the Project Administrator shall make the judgment determinations called for in the notes to the cost certification or upon its own initiative (whether unusually high construction costs are warranted, for example), and shall also do sample testing of the Developer's CPA's work papers to determine accuracy and adequacy. Part of the purpose of the analysis by the Project Administrator is to determine if the program is operating efficiently or if improvements might be made. If, during its analysis, the Project Administrator believes that the cost certification might contain errors, the developer shall be given the option to justify line items that may be outside the standard parameters set forth herein and to correct any mechanical errors that may have been noted. In such cases, the Developer's CPA may wish to re-issue its Independent Accountant's Report.

Prior to acceptance of the certified cost report, the Project Administrator shall deliver a copy of the Developer CPA's report to the municipality with the Project Administrator's determination of the developer's compliance with the limited dividend requirement. The municipality shall have the option of evaluating the report for accuracy (e.g., absence of material errors), applying the same standards as set forth herein for a period of 30 days after receipt. The Project Administrator will reasonably review any inaccuracies identified by the Municipality during this period and shall thereafter make a final determination of the developer's compliance with the limited dividend requirement.

II. Instructions to Developers

Selection of Developer's CPA. A developer may select any independent certified public accountant to examine the cost certification, provided that the accountant meets the following requirements:

- (i) is a qualified independent Certified Public Accountant licensed to practice accounting in the Commonwealth of Massachusetts;
- (ii) meets the independence standards of the AICPA;
- (iii) has been subjected to a quality control (peer) review, within the most recent time period as required by the AICPA and has received an unqualified report; and

- (iv) has current insurance policies that cover errors and omissions, general and vehicular liability, workers' compensation and professional liability.

Note: The Project Administrator reserves the right to issue an RFP for certified public accountants to perform the services of the Developer's CPA, resulting in an approved list of CPAs from which the developer may choose.

Timing. For home ownership projects, a cost certification shall be required within one hundred eighty (180) days after Substantial Completion (as defined below) or, if later, within ninety (90) days of the date on which all units are sold. If Substantial Completion occurs prior to 100% sell-out, interim statements must be provided quarterly, as required by the executed Regulatory Agreement. If all units are not sold within twenty-four (24) months of Substantial Completion, a sale price for the remaining unsold units shall be imputed in an amount equal to the average of the last three arm's-length sales of comparable units, and a cost certification shall be required within ninety (90) days thereafter.

A developer may request an extension of the submission deadline from the Project Administrator if there are significant unresolved construction claims or litigation.

"Substantial Completion" shall be deemed to have occurred for purposes of these instructions when the construction of the Development is sufficiently complete so that all of the units may be occupied and amenities may be used for their intended purpose, except for designated punch list items and seasonal work which does not interfere with the residential use of the Development.

The developer may choose the beginning date of the time period to be covered by the cost certification (such date to be not earlier than 24 months prior to the application for Site Approval, unless approved by the Project Administrator) and the end date of the time period to be covered by the cost certification (such date to be not later than 24 months from the date of Substantial Completion, unless approved by the Project Administrator). The selected time period shall be identified on the Schedules. All cost items shown in the Schedules shall have been paid by the selected end date, except that the developer may list as accruals estimates of the cost of designated punch list items required by the final construction plans, seasonal work and off-site mitigation required under the comprehensive permit, provided that the municipality has agreed to the cost of such accruals or such cost has been documented by an estimate from a non-related third party contractor.

Related Party Transactions. All related party transactions (resulting in project costs or revenues) must be disclosed and documentation must be provided identifying, where applicable, what portion of costs were paid to non-related third parties (e.g., subcontractors) and what portion were retained by related parties. In general, fees for services by related parties should not exceed amounts that would otherwise be reasonably paid for such services on an arm's length basis in the ordinary course of business. A "Related Party" is (i) any person that, directly or indirectly, through one or more intermediaries, controls or is controlled by or is under common control with the developer; (ii) any person that is an officer of, member in, or trustee of, or serves in a similar capacity with respect to the developer or of which the developer is an officer, member, or trustee, or with respect to which the developer serves in a similar capacity; (iii) any person that, directly

or indirectly, is the beneficial owner of, or controls, 10% or more of any class of equity securities of, or otherwise has a substantial beneficial interest (10% or more) in, the developer, or of which the developer is directly or indirectly the owner of 10% or more of any class of equity securities, or in which the developer has a substantial beneficial interest (10% or more); and (iv) any spouse of the developer or “significant other” cohabiting with the developer; (v) any parent, grandparent, sibling, child or grandchild (natural, step, half or in-law) of the developer; (vi) any employee of the developer and (vii) any spouse, parent, grandparent, sibling, child or grandchild (natural, step, half or in-law) of an employee of the developer or “significant other” cohabiting with an employee of the developer. The Project Administrator reserves the right to determine whether the related party test should apply in any other case where it appears reasonable under the circumstances.

III. Instructions to Developer’s CPA

General Instructions

Applicable Guidelines and Standards. Prior to initiating an examination of the cost certification in accordance with the AICPA attestation standards for a project in which the application for a Project Eligibility (Site Approval) Letter was submitted prior to 11/4/05, the Developer’s CPA should contact the Project Administrator to determine the applicability of the cost standards set forth in the *Local 40B Review and Decision Guidelines*, Appendix A, issued by the Massachusetts Housing Partnership (the “MHP Guidelines”). These standards are applicable to projects that applied for Site Approval on or after 11/4/05; for projects that applied for Site Approval before 11/4/05, the NEF Guidelines rules apply. If a project is not subject to the MHP Guidelines, identical limitations may still be applicable to the extent they are indicated in the NEF Guidelines or to the extent that they reflect pre-existing practice of the Project Administrator in evaluating cost certifications for construction projects financed by the Project Administrator. In certain projects, the executed Regulatory Agreement shall provide for different cost standards to be applied at cost certification, and the Project Administrator shall inform the Developer’s CPA of any change in these instructions when contacted by the Developer’s CPA prior to initiating an examination in accordance with the AICPA attestation standards of the project cost certification. All comprehensive permit projects require a cost certification, regardless of the date of the Project Eligibility (Site Approval) letter.

Schedule of Chapter 40B Maximum Allowable Profit from Sales. The Developer’s CPA shall examine, in accordance with the AICPA attestation standards, the Schedule of Chapter 40B Maximum Allowable Profit from Sales [for home ownership projects] to determine that the schedule presents fairly, in all material respects, the Chapter 40B maximum allowable profit from sales; that the development proceeds reflect revenue from all of the units in the project; that the calculated percentage profit figure is free of material errors and complies with the allowable level specified by Chapter 40B and the NEF Guidelines.

This schedule must include a disclosure of all unit sales to related parties, and the amount of revenue to be included for such sales shall be the greater of the actual sales price and the average sales price of the highest three arm’s-length sales of comparable units.

Schedule of Total Chapter 40B Project Costs. The Developer's CPA shall examine, in accordance with the AICPA attestation standards, the Schedule of Total Chapter 40B Project Costs to determine that the schedule presents fairly, in all material respects, the total Chapter 40B project costs; that it includes all cost categories which could reasonably be expected for the subject project; that there are no cost line items which do not relate directly to the development of the subject site (except for permitted overhead expenses, not duplicated in any other line item). Although certain costs may appropriately be listed in more than one line item, the Developer's Certificate includes a certification that no costs are included in the schedule more than once.

Specific Instructions

Land (Acquisition) Value. The NEF Guidelines state that, "Allowable acquisition cost shall not be unreasonably greater than the current appraised fair market value under existing zoning without a comprehensive permit in place." The terms "current" and "existing zoning" refer to the date of issuance of the Site Approval. The NEF Guidelines also provide that, "Reasonable carrying costs incurred related to the real estate including interest, taxes, insurance, and the costs related to option agreements may be included as project expenses. If a building or improvement to be used in the project is located on the land, reasonable maintenance costs incurred after the date of application and security may be included as project expenses."

The MHP Guidelines state that the allowable acquisition cost is "the fair market value of the site excluding any value relating to the possible issuance of a comprehensive permit (the As-Is Market Value) at the time of submission of the request for a project eligibility letter plus reasonable and verifiable carrying costs (Reasonable Carrying Costs) from that date forward."

Reasonable Carrying Costs may not exceed 20% of the As-Is Market Value of the site unless the carrying period exceeds 24 months from the date of application for Site Approval.

In determining the "fair market value" for cost certifications for which an appraisal has not already been commissioned by the Project Administrator, a land appraisal meeting the requirements of the MHP Guidelines (prepared by an appraiser approved by the Project Administrator) shall be required except as noted below:

- (i) if the project is 20 units or less and the developer provides a letter of support from the chief elected official waiving the appraisal requirement, the developer may submit satisfactory evidence (such as a local tax assessment, limited appraisal, or opinion of value from a licensed real estate broker) that reasonably supports the acquisition cost, or
- (ii) if the full value of the land is assumed to be zero and the profit level is below that allowed by the applicable subsidy program, an appraisal is not required.

Any exception to the appraisal requirement must be noted in the Developer's Certificate and by the Project Administrator during its analysis of the certified cost report.

If an appraisal is required, the Project Administrator shall evaluate the appraisal for substantive compliance with the MHP Guidelines during its analysis of the certified cost report. While paid for by the applicant, the appraisal shall be commissioned by (and name as the client) the Project

Administrator. The Project Administrator maintains a list of approved appraisers and may augment, reduce or alter the list of approved appraisers as it deems necessary or appropriate. All approved appraisers shall be, at a minimum, a General Real Estate Appraiser certified by the Commonwealth of Massachusetts and shall submit Self-Contained Appraisal Reports to the Project Administrator in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). The appraisal commissioned by the Project Administrator may, in accordance with USPAP, take into account the probability of obtaining a variance, special permit or other zoning relief, but it must exclude any value relating to the possible issuance of a comprehensive permit under Chapter 40B.

Note that any transfers of ownership occurring between the time of Site Approval and cost certification shall not affect allowable land value, and any amount paid in excess of such value shall be allowable only to the extent that there is documented evidence that the services performed by the seller would otherwise be includable in an allowable line item.

Hard Costs. Hard costs shall be fully documented and shall be limited to the hard cost line item categories set forth in the attached form of Schedule of Total Chapter 40B Project Costs. Note that, because of contingencies during construction, it is likely that many line item amounts listed in the pre-construction pro-forma budget last reviewed by the Project Administrator will change, or that some cost items may not have been originally included. In addition, the developer should follow specific restrictions in relation to the following line items:

Residential construction. Hard construction costs (including the contractor's General Requirements, Builder's Overhead, Builder's Profit (all defined below) and bond cost) should be carried on a square foot basis. The square footage cost should not exceed the reasonable square footage cost for construction of market rate housing consisting of the same building characteristics and unit type. As a "safe harbor" rule, this standard shall be presumed to have been satisfied if the square footage cost does not exceed 110% of the applicable square footage construction cost listed in the RS Means Residential Construction Cost Data (most recent edition published after Substantial Completion), adjusted for building characteristics and unit type (which may vary for particular units within the same development), and adjusted for geographic location. The developer/architect shall certify as to the accuracy and appropriateness of the RS Means data used for the project.

"General Requirements" are project-specific expenses (such as on-site supervision, field offices, temporary utilities and waste removal) that support the job as a whole rather than specific work items. "Builder's Overhead" is a portion of the costs incurred by the builder or general contractor to operate their business (such as office and administrative expenses) that is not attributable to any one job. "Builder's Profit" is the difference between the total cost of construction (including Builder's Overhead and General Requirements) and the amount paid to the builder/contractor.

In the case of a competitively selected general contractor, no detailed review of line items is necessary during cost certification if the overall construction cost is within industry norms (e.g. within 110% of RS Means data) and the developer and contractor both certify that the contract was executed at arm's length and no work was performed by related parties.

If construction costs exceed 110% of the applicable RS Means standard, a facts and circumstances test shall be employed to determine reasonableness of the excess costs. In such cases, the developer shall be required to provide documentation of excess costs together with a detailed explanation of the necessity for incurring such costs. Such explanation may include, for example, a comparison of features of comparable market rate units in the area, the use of green building technologies or the incurrence of extraordinary construction obligations. This explanation shall be included in the notes to the cost certification and the Project Administrator shall determine to what extent such excess costs are approved.

Site Development Costs. This category includes roads (including utilities in the roads), on-site septic system, on-site water system, blasting allowance, rough grading/site preparation, landscaping and utility connections. Because these costs are site-specific, they shall be documented in the developer’s records and accompanied by an explanation of the necessity of such costs, including, where appropriate, mitigation obligations imposed by the comprehensive permit. This explanation shall be included in the notes to the cost certification and the Project Administrator shall determine to what extent such excess costs are approved.

Note that the reasonableness standard for hard costs (110% of RS Means data) is based on information available to the Project Administrator as of the date of these instructions, and this standard may be updated periodically.

Soft Costs. Soft costs shall also be fully documented in the developer’s records and shall be limited to the soft cost line item categories set forth in the Schedule of Total 40B Project Costs. If applicable, developers should follow the standards for the following soft cost line items that are set forth in the Appendix to the MHP Guidelines:

Developer Overhead – Developer Overhead reflects the expenses of the applicant administering and managing the project during the permitting, financing, construction, marketing and cost certification phases and is not a component of allowable developer fee/profit. The allowable developer overhead costs for cost certification purposes should not exceed the following limitations (without need of supporting documentation):

TOTAL PROJECT SIZE	ALLOWABLE DEVELOPER OVERHEAD
Up to 4 units	\$20,000 (fixed amount)
5 - 20 units	\$4,000/unit for units 1-20
21 - 100 units	\$80,000 plus \$2,000/unit for units 21-100
101 - 150 units	\$240,000 plus 1,000/unit for units 101-150
151+ units	\$290,000 plus \$500/unit for units above 150

If overhead tasks typically performed by a developer are provided by development consultants or other third parties, the Developer Overhead allowance should be reduced accordingly, based on the following guidelines:

Further Defining Related Party Transactions. The developer ordinarily performs the following development tasks, for which the developer and related parties may not receive compensation beyond the maximum allowable developer’s fee and overhead:

- Investigating the site/property
- Setting the design criteria or design program
- Hiring engineers, cost estimators, surveyors
- Hiring designer
- Establishing cost limitations
- Determining the project size, use and ownership
- Coordinating legal review
- Awarding contracts
- Team coordination
- Construction monitoring
- Project approvals

If third parties (e.g., development consultants or lawyers) perform any of these standard "owner's" tasks, those costs must be included within the maximum developer's fee and overhead.

If the developer or a related party performs any services that would normally be provided by third parties (such as an in-house construction manager instead of a clerk of the works paid through an architect), costs for such services are only allowable, in addition to developer's fee and overhead, to the extent that such costs do not exceed what would otherwise be paid to a third party to perform those services in the ordinary course of business.

Commissions - Market Units - Commissions on the sales of the market units should not exceed 6% of the sales price. In cases in which the development entity is a related party to the brokerage agency, commissions are limited to 5% of the sales price. All advertising costs must be included within the commissions. The cost of model homes may be treated as a separate marketing cost.

Commissions/Marketing/Lottery Costs - Affordable Units -The maximum allowable brokerage or similar fee, including lottery costs, should be the greater of \$20,000 or 3% of the sum of actual affordable unit sales prices.

Total Soft Costs – Soft Costs should not exceed 28% of the residential construction line item on the Schedule of Total Chapter 40B Costs (as approved by the Project Administrator). If total soft costs exceed the 28% limit, a facts and circumstances test shall be employed to determine reasonableness of the excess costs. In such cases, the developer shall be required to provide documentation of excess costs together with a detailed explanation of the necessity for incurring such costs. Such explanation may include, for example, reasons for a particularly complex legal structure resulting in high legal fees. This explanation shall be included in the notes to the cost certification and the Project Administrator shall determine to what extent such excess costs are approved.

Note that the reasonableness standard for soft costs is based on information available to the Project Administrator as of the date of these instructions, and this standard may be updated periodically.

In the case of a related party general contractor, the contractor must disclose relationships with any related party subcontractors and any fees paid to related party subcontractors must be ordinary and reasonable. Limitations provided in the Appendix to the MHP Guidelines specifically set a maximum to Builder's Profit, Builder's Overhead, and General Requirements where related party construction managers or general contractors are involved. They are as follows:

- a. Builder's Profit — 6 percent of construction costs
- b. Builder's Overhead — 2 percent of construction costs
- c. General Requirements — 6 percent of construction costs

It is acceptable for a particular line item to exceed the limit set forth above so long as the total of the three line items does not exceed 14%. The 14% allowance for Builder's Profit, Builder's Overhead and General Requirements for related party general contractors requires certification that the general contractor performed all of the following tasks that are typically required of general contractors:

- Construction of building
- Supervision and coordination of work
- Job site safety
- Project scheduling
- Submission of shop drawings
- Preparation of payment requests
- Warranty of work

If another entity was paid to perform any one of these functions cost may be disallowed and adjustments shall be made to account for the greater profit.

If a developer or related entity makes a loan to the project, interest may only be recognized on developer contributions that exceed 20 percent of total development costs. Any such loans should be evidenced by a note or mortgage and receive interest no higher than the rate established by the primary construction lender on the project.

Other Matters. The Developer's CPA shall also perform any other procedures deemed appropriate in the circumstances.

IV. Project Administrator Review and Determination of Compliance with Limited Dividend Requirement; Notice to Municipality

The developer shall submit the cost certification which has been examined in accordance with the AICPA attestation standards to the Project Administrator. The Project Administrator shall analyze these materials generally to determine the developer's compliance with the instructions set forth herein and ultimately to determine compliance with the limited dividend requirement. This analysis may result in questions and clarifications being asked by the Project Administrator of the developer and/or the Developer's CPA, and may also result in adjustments to overall profit calculations.

As part of its analysis, the Project Administrator shall make the judgment determinations called for in the notes to the cost certification or upon its own initiative (for example, whether unusually high construction costs are warranted), and shall also do sample testing of the Developer's CPA's work papers to determine accuracy and adequacy. Specifically, the analysis is meant to determine that the material contained in the examined cost certification covers the full scope and time frame of the development; that the related party disclosures are included in the notes and the nature and the amounts of those related party activities are detailed; and that these disclosures appear consistent with other project documentation submitted; that a CPA licensed to practice in the Commonwealth of Massachusetts conducted the examination and that the Developer CPA's Independent Accountant's Report covers general requirements of performing an examination under the attestation standards established by the AICPA vs. any other type of engagement. Part of the purpose of the analysis by the Project Administrator is to determine if the program is operating efficiently or if improvements might be made. If, during its analysis, the Project Administrator believes that the cost certification might contain errors, the developer shall be given the option to justify line items that may be outside the standard parameters set forth herein and to correct any mechanical errors that may have been noted. In such cases, the Developer's CPA may wish to re-issue its Independent Accountant's Report.

Prior to acceptance of the certified cost report, the Project Administrator shall deliver a copy of the Developer CPA's report to the municipality with the Project Administrator's determination of the developer's compliance with the limited dividend requirement. The municipality shall have the option of evaluating the report for accuracy (e.g., absence of material errors), applying the same standards as set forth herein for a period of 30 days after receipt. The Project Administrator will reasonably review any inaccuracies identified by the Municipality during this period and shall thereafter make a final determination of the developer's compliance with the limited dividend requirement.

Attachments:

- Schedule of Total Chapter 40B Maximum Allowable Profit from Sales
- Schedule of Total Chapter 40B Project Costs
- Developer's Certificate
 - Exhibit A – Disclosure of Related Party Transactions
 - Exhibit B – Identification of RS Means Construction Data
 - Exhibit C – Release to Developer's CPA
- General Contractor's Certificate
- Form of Independent Accountant's Report – Developer's CPA
- Examination Program (Parts A through G) for Developer's CPA