

Testimony of Massachusetts Inspector General Gregory Sullivan on October 23, 2007 Dealing with Rampant Financial Abuses and Alleged Criminal Activity Regarding Implementation of the State's Chapter 40B "Affordable Housing" Statute

Rep. Honan: Nice to see you Greg - former member of the House of Representatives - good to see you back.

I.G. Sullivan: Thank you very much Mr. Chairman for the invitation to testify today. I am Greg Sullivan, State Inspector General. My office has been in the midst of a comprehensive review of a narrow issue within Chapter 40B - an issue of cost certification. Under 40B, if developers earn over twenty percent profits under regulatory agreements the profit goes to the city or town.

It's very important in a program like this that it be monitored very carefully.

We have already done seven reviews to date and we have identified approximately four to five million dollars within these seven towns that we conclude is due to those cities or towns.

These are projects, 40B projects, that have been completed, reviewed, gone through cost certification and are finished.

We then went back with an independent auditing firm and scrutinized the record. And in those towns we found **four to five million dollars due those cities and towns.** We conclude that the solutions that have been recommended to date to fix 40B - in the cost certification area by subsidizing agencies wholly inadequate. In fact they would make the situation worse- not better - than it is today.

Now we'll talk about why we make a statement like that.

The Massachusetts House and Senate - this is an analogy to the school funding program - the Massachusetts House and Senate undertook a major reform of the school building funding program a couple of years ago. They did so after the State Auditor Joe DeNucci's office did a review of the school funding program. And when the Auditor went into the Department of Education he found that fewer than thirty percent of the school projects that had been built and funded by the state had been audited for cost certification. Fewer than thirty percent. And all the ones that had been audited he found that more than half were still in the envelopes, unopened. The legislature was not pleased with that performance. And, they transferred the operation of the school funding program to a new authority - the school building authority. **I would argue that Chapter 40B cost certification is worse than that.**

In our estimation, fewer than thirty percent of the 40B programs have ever been cost certified at all. And, of those that have been cost certified - we have found millions of dollars of errors in the ones that have had perfunctory reviews.

I would conclude that cost certification under 40B has been virtually nonexistent since the program's origins.

In a meeting that I had yesterday with Undersecretary Tina Brooks she acknowledged to me that she thinks that the cost certification program has been basically nonexistent as it has operated. What does this mean and what do we recommend?

We recommend that DHCD bring some adult supervision to the 40B program.

The biggest finding that we have made about 40B is what we consider to be the central problem. When the state agency in charge of 40B promulgated regulations long ago, they _____ that the limited dividend, **the determination of how much profit a developer could make and how big the project could be would be**

left up to an agreement between the bank and the developer.

That is what the regulations say today.

As you mentioned I served in the legislature. I served for 18 years. And I -- and when I dealt with any legislator -- were talking about 40B -- I have yet to meet a single member of the House or Senate who said that the intent of 40B was that the profit limits would be defined by the developers and the bank and not the state government. How can you have a program where the developer and the bank determine and review the profit? That is the lot today by regulation.

When people talk about 40B they talk about the fact that the HAC, the Housing Appeals Committee, almost always decides on behalf of the developer when it comes to profit issues. That is because, when they read the regulations the agencies that are determining - that are regulating this are the banks and the developers.

This is not the legislative intent. That should never have happened.

This is the number one problem with 40B that has to be rectified.

I want to point out the example of the town of Sharon that happened very recently to show you this is a contemporaneous problem, not a problem of the past.

We saw an appraisal of a 40B project in Sharon in Representative Kafke's and Senator Timilty's district - and we contacted them, in the community because of our concern. the developer submitted his own appraiser's report saying that the land was worth nine and one-half million dollars. We estimate that the land was worth far less than that.

We noticed in the appraisal that they used as a 'comp' an individual land sale in Westwood - about ten miles away - that went for three and one-half million dollars - as a 'comp' to this 40B property. And, we noticed in this appraisal that it, the price, was contingent on how many units of 40B's could be used. this is strictly against the rules of 40B. So, for the first time in the program's history MassHousing hired an independent appraiser at the request of Senator Timilty and Representative Kafke. And when that independent arms-length appraiser came back he said that the land was worth two and one-half million dollars not worth nine and one-half million dollars.

That project had already been approved.

It had already gone through the state subsidizing agency to get a project eligibility approval.

So what does this mean?

That seven million dollars that would have gone to the developer belonged to the town. It did not belong to the developer. This is a flaw in the system.

So, we have recommended that there be appraisals of the property up front by an arms-length appraiser prequalified by DHCD [Department of Housing and Community Development] and selected by the town. The reforms, so called, that have been promulgated by the subsidizing agencies - they don't fix the problem, they make it worse. **Because, the reforms would allow the developer to pick the appraiser and, put in permanent regulation, permanent policy.**

So, in other words: we identified the problem and pointed to exact details - that project in Sharon was canceled as a result of this - so, what is the answer? The answer is to make it permanent that the developer should choose the appraiser! **It makes no sense.**

DCAM [Division of Capital Management] doesn't do that.

When the legislature transacts property rights they ask DCAM to hire an arms-length appraiser.

In fact, the legislature is so careful when they dispose of property that they have a second appraisal done on the first appraiser's methodology - that our office often does.

Would you ever buy a piece of property based upon the estimate of the appraisal of the seller? Who would ever do that? That is what the proposal is for the so-called 'reform' that's been promulgated by the subsidizing agency. We think the appraisal should be done up front from a list certified by DHCD selected by the town. That would take care, in our opinion, of forty percent of the problem with 40B cost certification.

The next issue: Other Abuses.

In one of the cases that we reviewed, we found that more than a million dollars worth of expenses had been added to the expense report for 40B for work that was not done on that site but, was done elsewhere on another site. This project had already been cost certified. It had already been reviewed and approved and finalized.

We think that the CPA firms that review these cost certifications should not be the developers' CPA. We see CPA's that are uncles and relatives in small firms and sometimes even parties to the development. The simplest methodology to utilize in the selection of a CPA is to have DHCD certify the CPA firms for the cost certification and have the municipality pick from that list. That's what we've been recommending. What do the proposed reforms include? The developers will pick the CPA!

That is dead wrong.

Next: sale of units.

We saw examples where the developers were coming up to the twenty percent profit limit.

They sold units to a related party's trust comprised of their wives and, sold more than - and hid more than, a million dollars in profits. Nobody was looking.

Another example: labor.

Where the developer included in his expenses labor costs for people that were doing site work, site preparation work - where they claimed they had paid seventy dollars an hour to the laborers.

So, we went and got the records from the laborers. They were paid ten to fifteen dollars an hour.

They were just wrong. False information in a system overseen by developers and banks - not by the government.

We are recommending that DHCD promulgate the regulations as we think the legislature intended, for profit limits; that a CPA firm be selected from a prequalified list from DHCD.

That would take care of another forty percent of the problems of 40B cost certification.

Next issue: cutting off municipal rights.

I want to show you a document that I say offends the sensibilities.

This began a year ago. When the IG's office first got involved with the 40B investigation we started pointing out and documenting these abuses. Many municipalities started to look at 40B and said: Are we owed some money here? They [developers] kept the profits over twenty percent.

But in the history of the program only seventeen thousand dollars [\$17,000] has ever been paid to a city or town before we got involved. So, they started to look. And what happened under Jane Wallis Gumble [Former head of DHCD] is they responded by promulgating a letter stating that review of profit certifications is not the purview of the cities and towns. They [The cities and towns.] should not be

involved in that. **That, to me, is outrageous. Because, they [The cities and towns.] were a party and they have a right to receive the profits over twenty percent.**

But worse than that is, they promulgated this document - which in the last year they have given Zoning Board of Appeals and they're making the Zoning Board of Appeals sign the statement, each member, in which they agree that the limited dividend requirement, that's the profits, shall be determined solely by the regulatory agreement - that's the bank and the developer. The bank, "using the standards of the project administrator," of the bank, applicable to the Comprehensive Permit for a project in accordance with guidelines.

In other words: what's happened in the past year once we brought these problems to light - is they're making the Zoning Board of Appeals sign a statement in which they give up their right to go to court, to get their [The town's.] money and they say, if there's a dispute it will be decided by the bank!

That is what's going on.

And when you - when you hear about reforms that allow the towns to review - to review these project certifications for thirty days, please be aware that it says in the same document that while the municipality has the option of evaluating, it will be the bank that determines, that makes the final determination - not the courts - and, the municipalities have no rights.

So, in conclusion Mr. Chairman, members of the committee, I hope that the legislature will adopt statutory changes to modify 40B if, the regulations aren't changed to incorporate the provisions that I'm calling for. This is not a small problem.

This 40B scandal represents one of the biggest abuses in state history, in my opinion, in terms of dollars and lack of oversight. Now we have new people in charge under the administration. We're calling for Adult Supervision to come in and rectify these problems.

In the seven communities we reviewed, five had problems amounting to over four million dollars owed to the cities towns. Who is going to look at the other communities? If I were reporting that in a small sample we found that level of abuse - is someone going to look at the other communities and the active projects going on today? This isn't just an issue of fixing the problem going forward. There are current projects and current obligations of developers to pay the cities and towns today.

So, I'm calling for reform going forward and for enforcement of the rules that are in the books today and, a comprehensive review.

Thank you very much...[Applause]