

## PREPARATION OF COST CERTIFICATION FOR 40B RENTAL DEVELOPMENTS

### Inter-Agency 40B Rental Cost Certification Guidance for Owners, Certified Public Accountants and Municipalities

---

#### *for Developments not Using Low-Income Housing Tax Credits*

---

#### **I. Introduction**

*NOTE: This Guidance and all the relevant calculation documents needed to complete a cost certification are found on a dedicated basecamp site available to users of these materials. To access the basecamp site, go to:*

<https://40bcostcert.basecamphq.com>

*Username: guest40*

*Password: guest04*

Outlined below are the procedures relating to the preparation and submission of the examined cost certifications required to be provided by owners, developers or subsidizing agency borrowers (“Owner”) upon completion of comprehensive permit (Chapter 40B) developments pursuant to the provisions of the Commonwealth of Massachusetts comprehensive permit regulations (M.G.L. Chapter 40B, 760 C.M.R. 56.00), and the Comprehensive Permit Guidelines issued by the Massachusetts Department of Housing and Community Development (DHCD) (collectively, the “Comprehensive Permit Rules”). This Guidance is applicable to rental developments subsidized, financed and/or overseen under the Comprehensive Permit Rules by the Massachusetts Department of Housing and Community Development (DHCD), the Massachusetts Housing Partnership (MHP), MassHousing and MassDevelopment (each, a “Subsidizing Agency”).

The purpose of requiring an examination of the cost certification is to assist the Subsidizing Agency in determining whether the Owner has complied with the applicable profit limitation for the development under the Comprehensive Permit Rules. The objective of this Guidance is to provide clear guidance to Owners, accountants and municipalities about how determination of the Owner’s compliance with the limited dividend requirement under Chapter 40B for this program shall be made.

***If you are an owner of a 40B project also using low-income housing tax credits, this is not the correct guidance document. Please obtain the 40B Rental Cost Certification Guidance on the basecamp site applicable to 40B tax-credit projects.***

## **II. Summary of Process**

Except as noted in the paragraph below entitled “Revised Process for Certain Developments”, the Owner’s cost certification shall be examined by an independent certified public accountant (the “Owner’s CPA”). Therefore, in completing the cost certification, the Owner, and, as necessary, members of the Owner’s development team, must complete the forms contained in Attachments A through G, and provide them to the Owner’s CPA, and, based on the information in Attachments A through G, the Owner’s CPA must report on the cost certification according to the form of accountant’s report attached as Attachment H. It is the Owner’s responsibility to submit Attachment A through G, along with the Independent Accountant’s Report (Attachment H) to the Subsidizing Agency.

Specifically, Owners must provide information to the Owner’s CPA using the schedules attached hereto and listed below:

**Attachment A** – Schedule of Actual and Budgeted Development Sources and Uses.

**Attachment B** – Schedule of Total Chapter 40B Maximum Allowable Developer Fee and Overhead

**Attachment C** – Schedule Showing Calculation of Owner’s Equity and Annual Limited Dividend under Chapter 40B

**Attachment D** – Owner’s Certificate, including Exhibit A:  
*Exhibit A* -- Disclosure of Related Party Transactions

**Attachment E** – Architect Certification Regarding the RS Means Cost Estimation Analysis

*Exhibit 1* – RS Means Cost Estimation Reporting Form

*Exhibit 2* – Instructions to Architect for Completion of RS Means Cost Estimation Analysis

**Attachment F** – Form of Release for Owner’s CPA to Share Information with Subsidizing Agency

**Attachment G** --General Contractor’s Certificate

**Attachment H** – Independent Accountant’s Report

**Revised Process for Certain Developments:** Owners of certain developments, described below, may, in the interest of cost savings, be allowed to complete the cost certification without the engagement of third-party professional services, as follows:

- Engagement of Certified Public Accountants: For developments of any size that are owned by non-profit organizations or public agencies, the cost certification may be completed without the engagement of a CPA. In these cases, the Owner must submit Attachments A through G to the Subsidizing Agency for its review and otherwise comply with this guidance unless an alternative cost certification is acceptable to the Subsidizing Agency. Please note that a development with an

owner wholly-owned by a non-profit organization or public agency [i.e. a limited liability company (LLC) with a single non-profit or public agency member] may be treated as a development owned by a non-profit organization or public agency and thus be eligible for the revised process described in this paragraph. A development *sponsored* by a non-profit organization or public agency but not wholly-owned by such entity does not qualify for this revised process. Determinations regarding the requirements for cost certifications for developments owned by non-profit organizations or public agencies shall be made at the discretion of the Subsidizing Agency.

- Engagement of Architects: For developments of 20 or fewer units that do not have an architect, the Owner is not required to hire an architect to complete Attachment E (and Exhibit 1 thereto). In these cases, a qualified professional, such as an engineer or contractor associated with the development, must complete Attachment E and Exhibit 1.

The Owner must provide to its CPA any other information required by the Owner's CPA in order for it to issue its report. It is the duty of the Owner to ensure that any and all information needed to perform an examination is provided to the Owner's CPA.

At the conclusion of its examination, the Owner's CPA shall issue an Independent Accountant's Report in the form attached hereto (Attachment H), stating that its examination was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants and that the attached schedules were prepared on the basis of accounting and reporting practices prescribed by the Subsidizing Agency. The accounting and reporting practices prescribed by the Subsidizing Agency for project cost certification examinations 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 Owner shall be analyzed by the Subsidizing Agency or its designee. This analysis may result in questions being asked and clarifications being requested by the Subsidizing Agency of the Owner and/or the Owner's CPA. As part of its analysis, the Subsidizing Agency shall make the 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 Owner's CPA's work papers to determine accuracy and adequacy. If, during its analysis, the Subsidizing Agency believes that the cost certification might contain errors, the Owners 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 Owner's CPA may wish to re-issue its Independent Accountant's Report.

Prior to acceptance of the certified cost report, the Subsidizing Agency shall deliver a copy of the Owner's CPA's report to the Municipality with the Subsidizing Agency's determination of the Owner's compliance with the Comprehensive Permit Rules. 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 Subsidizing Agency will reasonably review any inaccuracies identified by the Municipality during this period and shall thereafter make a final determination of the Owner's compliance with the Comprehensive Permit Rules.

### **III. Instructions to Owners**

**Selection of Owner's CPA.** The Owner may select any independent certified public accountant to prepare the cost certification, provided that the accountant has been prequalified by DHCD. In order to be prequalified by DHCD, CPAs must:

- be a qualified independent Certified Public Accountant licensed to practice accounting in the Commonwealth of Massachusetts;
- meet the independence standards of the American Institute of Certified Public Accountants (AICPA);
- have been subjected to a quality control (peer) review, within the most recent time period as required by the AICPA and received an unqualified report; and
- have current insurance policies that cover errors and omissions, general and vehicular liability, workers' compensation and professional liability.

CPAs interested in being prequalified by DHCD should submit the following information to DHCD, specifically to Adrian Walleigh, DHCD Counsel (whose contact information is as follows: [Adrian.Walleigh@MassMail.State.MA.US](mailto:Adrian.Walleigh@MassMail.State.MA.US); 617-573-1504):

- A Letter of Interest providing the name, firm name (if applicable), address, telephone and fax numbers, and license number for the CPA;
- An original Certificate of Good Standing issued by the Massachusetts Division of Licensure within thirty (30) days of the submission to DHCD;
- A copy of the relevant quality control (peer review) report, and
- A copy of the CPA's insurance certificate.

Prequalification by DHCD will be good for a period of two (2) years from the date that DHCD notifies a CPA that it has met the standards set forth below, provided that the CPA maintains compliance with such standards.

**Timing.** A final cost certification shall be required within ninety (90) days after Substantial Completion, unless otherwise allowed by the Subsidizing Agency.

"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 Owner must choose the beginning and end dates of the time period to be covered by the cost certification as follows. The beginning date must be not earlier than the later of a) 90 days prior to the date of the option agreement or purchase and sale agreement establishing the Owner's initial site control of the subject property, or b) 24 months prior to the application for project eligibility, unless approved by the Subsidizing Agency, and the end date must be not later than 60 days after the date of Substantial Completion, unless approved by the Subsidizing Agency. The selected time period shall be identified on Attachment A. All cost items shown Attachment A shall have been paid by the selected end date, except that the Owner may list as accruals the cost of designated punch list items required by the final construction plans,

seasonal work and off-site mitigation required under the comprehensive permit. Regarding accrued costs related to off-site mitigations, the Owner must have obtained the agreement of the Municipality, or an estimate from a non-related third party contractor, as to the cost of such accruals.

Compliance with Maximum Allowable Development Fee. The instructions at the bottom of Attachment B makes clear the maximum allowable development fee. If the cost certification shows that the combination of paid development fee, paid developer overhead, and paid fees to development consultants is in excess of the allowed amount, then developer may be required to refund the excess amount to the Subsidizing Agency.

Related Party Transactions. All related party transactions (resulting in project costs or revenues) must be disclosed and documentation must be provided by the Owner to the Owner's CPA, in the form shown on Exhibit A to Attachment D (Owner's Certificate), identifying, where applicable, what portion of costs were paid to related parties. 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 Owner; (ii) any person that is an officer of, member in, or trustee of, or serves in a similar capacity with respect to the Owner or of which the Owner is an officer, member, or trustee, or with respect to which the Owner 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 Owner or of which the Owner is directly or indirectly the owner of 10% or more of any class of equity securities, or in which the Owner has a substantial beneficial interest (10% or more); (iv) any spouse or "significant other" cohabiting with the Owner; (v) any parent, grandparent, sibling, child or grandchild (natural, step, half or in-law) of the Owner, (vi) any employee of Owner, and (vii) any spouse, parent, grandparent, sibling, child or grandchild (natural, step, half, or in-law) of an employee of the Owner, or a "significant other" cohabiting with an employee of the Owner. The term "Owner", as used in this section, shall be deemed to include the Developer, as defined in the Comprehensive Permit Rules.

The Subsidizing Agency reserves the right to determine whether the related party test should apply in any other case where it appears reasonable under the circumstances.

#### **IV. Instructions to Owner's CPA**

The Owner's CPA will review Attachments A through G submitted by the Owner and base its examination on this information.

**Attachment A – Schedule of Actual and Development Sources and Uses.** The Owner's CPA shall examine, in accordance with the AICPA attestation standards, the Schedule of Actual and Budgeted Development Sources and Uses to determine that the schedule appears to include cost categories which could reasonably be expected for the subject project; that the calculations presented are free of material errors; that there are no cost line items which do not relate directly to the development of the subject site. Although certain costs may appropriately be listed in more than one line item, the schedule of costs must include a certification that no costs are included in the schedule more than once. The schedule must show both sources and uses, and include the budgeted sources and uses schedule that was approved by the Subsidizing Agency at the time of final approval prior to the start of construction.

The Owner's CPA shall also take into account the limitations for particular line items in the Owner's cost certification as described in Part V below (Specific Instructions) and perform any other procedures deemed appropriate in the circumstances.

**Attachment B -- Schedule of Total Chapter 40B Maximum Allowable Developer Fee and Overhead.** The Owner's CPA shall examine, in accordance with AICPA attestation standards, the Schedule of Total Chapter 40B Maximum Allowable Developer Fee and Overhead to determine that the calculations presented are free of material errors and comply with the allowable level dictated by the Comprehensive Permit Rules. The maximum allowable developer fee calculation is based on the calculation used by DHCD in its administration of the tax credit program.

**Attachment C – Schedule Showing Calculation of Owner's Equity and Annual Limited Dividend Under Chapter 40B.** Pursuant to the Comprehensive Permit Rules, annual dividend distributions shall be limited to 10 percent of the Owner's Equity. The calculation of Owner's Equity must be done in accordance with the form shown on Attachment C.

**Attachment D (including Exhibit A) – Owner's Certificate.** The Owner must execute the Owner's Certificate included as Attachment D, and attach Exhibit A, described hereunder, to the Certificate.

- ***Exhibit A*** (Disclosure of Related Party Transactions) requires the Owner to disclose the presence of payments to, or rental of units to, any related parties. See "Related Party Transactions" under Part III above, and "Further Defining Related Party Transactions" under Part V below.

**Attachment E (Architect Certification Regarding the RS Means Cost Estimation Analysis)** must be executed by the architect or other professional completing the RS Means cost estimating analysis, whether by the on-line Costworks program or the annual Square Foot Cost Book. Exhibit 1, described below, must be attached.

NOTE on rehabilitation projects: If the project involves expenditures for rehabilitation either along with new construction, or instead of new construction, the RS Means Cost Estimation mechanisms are not applicable for the evaluation of such rehabilitation costs. In these cases, the Subsidizing Agency reserves the right to require a third party evaluation of the reasonableness of the costs of any portion of the project that involved rehabilitation.

- ***Exhibit 1*** (RS Means Costworks Analysis Reporting Form) is the spreadsheet which shows the results of the cost estimating analysis and calculates the variance between actual costs and the RS Means cost estimate.
- ***Exhibit 2*** (Instructions to Architect for Completion of RS Means Cost Estimation Analysis) provides instructions for the completion of the RS Means Cost Estimation Analysis. 40B regulations require the Owner to provide evidence of the reasonableness of the hard costs for the development, by means of cost estimating tools available from RS Means. Two specific tools are acceptable – the latest annual edition of the publication RS Means Residential Cost Data (commonly referred to as the "Square Foot Cost Book") or the on-line RS Means Costworks program. Essentially, the Owner is required to provide an explanation for the development's actual hard costs if they exceed, by more than 10%, the estimated cost determined for a similar development

through the use of the RS Means cost estimating tools. Exhibit B provides guidance to the architect or other professional who is completing this cost estimating task.

**Attachment F (Form of Release for Owner's CPA to Share Information with Subsidizing Agency)** is the Owner's authorization to the CPA to share information with the Subsidizing Agency, should the Subsidizing Agency have questions about the cost certification.

**Attachment G – General Contractor's Certificate.** This certificate relates to the general contractor's contract for the completed development, and requests certifications as to the Owner's payments to the general contractor, the amount of the original contract and the amounts, if any, of any change orders to the general contract. There is also a requested disclosure of any contracting or subcontracting parties which are related to the Owner.

**Attachment H – Form of Independent Accountant's Report.** This attachment provides the required content of the accountant's examination report and the minimum disclosures required in the notes to the report. The Owner must provide this Attachment to his/her certified public accountant .

## **V. Specific Instructions**

### **Land (Acquisition) Value.**

The Comprehensive Permit Rules state that the allowable acquisition cost for purposes of compliance with 40B is "the fair market value of the site under current zoning (As-Is Market Value) at the time of submission of the request for Project Eligibility plus reasonable and verifiable carrying costs (Reasonable Carrying Costs) from that date forward."

***Special Note:*** In a few cases, the property has already been issued a Comprehensive Permit prior to an application for a new Project Eligibility approval. In these cases, the valuation must not attribute any value related to the previously approved Comprehensive Permit, but must, rather, value the property under the zoning that was in place prior to the issuance of that previously approved Comprehensive Permit.

In Attachment A, the accountant inserts this figure at line 160, referred to as "Pre-Permit Land Value", which is defined in detail on the third tab of the worksheet containing Attachments A through C.

In determining the "fair market value" for cost certifications for which an appraisal has not already been commissioned by the Subsidizing Agency, a land appraisal meeting the requirements of the Comprehensive Permit Rules (prepared by an appraiser approved by the Subsidizing Agency) shall be required except under the following circumstances:

- (i) if the project has 20 or fewer units, or is sponsored by a non-profit organization or a public agency, upon the written request of the chief elected official, the Subsidizing Agency may waive the appraisal requirement, provided that the Owner submits 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 and explained in the Owner's Certificate and by the Subsidizing Agency during its analysis of the certified cost report.

If an appraisal is required, the Subsidizing Agency shall review the appraisal for substantive compliance with the Comprehensive Permit Rules. While paid for by the applicant, the appraisal shall be commissioned by (and name as the client) the Subsidizing Agency. The appraiser selected must be among the list of appraisers approved by the Subsidizing Agency. 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 Subsidizing Agency in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). The appraisal commissioned by the Subsidizing Agency 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 documented on Attachment A (Schedule of Actual and Budgeted Development Sources and Uses) and supported by detail as requested by the Subsidizing Agency. Note that, because of contingencies during construction, it is likely that many line item amounts listed in the original pro-forma budget will change, or that some cost items may not have been originally included. In addition, the Owner should follow specific instructions in relation to the following line items:

- Construction. Hard construction costs will include structural costs, sitework costs and the contractor-related items of General Conditions, Builder's Overhead, and Builder's Profit (all outlined below). They will be shown on a per-square foot basis and a per-unit basis, as well by dollar amount, as required on Attachment A. The Owner may be requested by the Subsidizing Agency to provide additional detail by trade line item.
- Cost Reasonableness: The Owner will be requested to establish cost reasonableness through the use of the RS Means "Costworks" program or of the RS Means Square Foot Cost Book, the procedures for which are outlined in Exhibit 2 to Attachment E ("Instructions to Architect for Completion of RS Means Cost Estimation Analysis"), which returns standard costs based on building characteristics, adjusted for geographic location. If the construction costs exceed 110% of the applicable RS Means standard returned by the cost estimation analysis, a facts and circumstances test shall be employed to determine reasonableness of the excess costs. In such cases, the Owner 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 cost certification, and the Subsidizing Agency shall determine to what extent such excess costs are approved.

The Owner's architect shall certify as to the accuracy of the RS Means data used for the development. The form for this certification is provided at Attachment E, and must include Exhibit 1 (RS Means Cost Analysis Reporting Form) as an attachment.



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

- “General Conditions” 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.

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. These costs must be itemized on Attachment A, under the “Construction Costs – Site Work” section. Because these costs are site-specific, they shall be documented and accompanied by an explanation of the necessity of such costs, including, where appropriate, mitigation obligations imposed by the comprehensive permit.

Soft Costs. Soft costs shall also be fully documented and shall be reflected in detail on Attachment A. Soft Costs should not exceed a reasonableness standard applied by the Subsidizing Agency. If total soft costs exceed this standard, a facts and circumstances test shall be employed to determine reasons for the excess costs. In such cases, the Owner 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. The Subsidizing Agency must approve all such excess costs.

Further Defining Related Party Transactions. The Owner ordinarily performs the following development tasks, for which the Owner 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 in the calculation of the maximum allowable developer's fee and overhead.

If the Owner 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.

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. The maximum allowed Builder's Profit, Builder's Overhead, and General Conditions amounts are as follows:

- Builder's Profit — 6 percent of construction costs
- Builder's Overhead — 2 percent of construction costs
- General Conditions — 6 percent of construction costs

It is acceptable for a particular line item to exceed the limits 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 Conditions 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, then the cost may be disallowed and adjustments shall be made to account for the greater profit.

If an Owner or related entity makes a loan to the Project, interest may only be recognized on Owner 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.

Examination Notes. The Subsidizing Agency shall analyze the cost certification notes section to determine that the material contained in the examined cost certification report 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.

Other Matters. The Subsidizing Agency shall also perform any other procedures deemed appropriate in the circumstances.

Records Retention. The Owner's Certificate shall include an agreement to retain all project records for a period of four years from the date the Subsidizing Agency accepts the final report and to allow the Subsidizing Agency and the Municipality the right to inspect such records at reasonable times during the retention period.