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STATEMENT OF

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BEFORE THE

CIFR SUBCOMMITTEE ON PUBLIC BUILDINGS AND GROUNDS

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION H3104

HOUSE OF REPRESENTATIVES

ON THE

COST AND BUDGETARY IMPACT

OF THE

GENERAL SERVICES ADMINISTRATION'S 17

PURCHASE CONTRACT PROGRAM

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Mr. Chairman and members of the Subcommittee:

We are pleased to appear before you to discuss our October 17, 1979, report on the cost and budgetary impact of the General Services Administration's purchase contract program. The Subcommittee requested this report to assist it in considering legislation to restore purchase contract authority to the General Services Administration. We were asked to compare purchase contracting with funding by appropriations (direct Federal construction) and with leasing as ways to finance the acquisition of space for Federal departments and agencies. We were specifically asked to analyze and compare the financial benefits and costs, the budgetary impact, and the secondary impact on the local tax structure of the various alternatives. In addition, we were asked to examine options to, and possible pitfalls of, a program such as the General Services purchase contract program, which expired in June 1975.

PURCHASE CONTRACT AUTHORITY

GSA had 3-year purchase contract authority under both the Public Buildings Purchase Contract Act of 1954 and the Public Buildings Amendments of 1972. Under these acts, GSA used two different financing methods to obtain financing of $1.4 billion for 97 projects.

Under the so called package method, where a single contract is awarded for both construction and financing, GSA entered into agreements with contractors for the construction and financing of 52 relatively small projects: 29 under the 1954 act and 23 under the 1972 act, with combined financing totalling $146.7 million. GSA makes semiannual payments to the contractors for interest and real estate taxes, and for amortization of principal. At the end of the contract period, the Government takes title to the buildings.

Under the second financing method--called the dual method--GSA contracted separately for the construction and financing of 45 building projects under the 1972 act. Financing of $691.5 million was obtained through the sale of participation certificates and about $534 million was borrowed from the Federal Financing Bank. As in the case of the package method of financing, GSA pays real estate taxes to the local community during the purchase contract term. Our July 11, 1979, report to the subcommittee (LCD-79-320) discusses financing with participation certificates in more detail.

GSA estimates that the payments for purchase contracting will be about $4.4 billion for the 97 projects--$3.1 billion for principal and interest, $1.3 billion for real estate taxes, and approximately $300,000 for administrative expenses.

FEDERAL BUILDINGS FUND

The Public Buildings Amendments of 1972 also established the Federal Buildings Fund which started operating in fiscal year 1975. Collections for rents charged to agencies occupying GSA controlled space are deposited in the Fund and are available to GSA for managing and acquiring real property.

When General Services officials testified on the 1972 law authorizing the establishment of the Fund, they estimated that $200 to $225 million a year would be available from the Fund for construction. Since 1975, however, the Fund has been unable to generate sufficient revenue to finance both operating and capital requirements. Therefore, an average of only $50 million a year has been available for construction. This is about $65 million a year less than was available for construction through direct appropriations before the Fund was established. The present level of funding for construction is simply not sufficient to reduce the backlog of needed projects or to bring about a meaningful reduction in leased space.

Because the money for construction, either through direct appropriation or through the Federal Buildings Fund has been limited, GSA has relied on leasing as the only practicable means of obtaining needed space. From fiscal year 1966 through fiscal year 1979, although leased space has more than doubled and the cost of lease space has more than tripled, there has been no appreciable increase in Government-owned space.

FINANCIAL BENEFITS AND COSTS

Purchase contracting has been used effectively in the past to finance the construction of public buildings. However, financing by participation certificates or private developers has been more costly than direct federal construction because the cost of capital for direct Federal construction--as measured by the interest rate on long-term Treasury bonds--is lower. Direct loans from the Federal Financing Bank, a third source of financing, have carried interest rates of one-eighth to three-eighths of a percent higher than the rates on Treasury securities of comparable maturity. This rate differential is an additional cost to borrowing agencies, such as General Services, but is not a significant cost to the Government as a whole because part of the differential is accumulated by the Financing Bank as profit.

GSA obtained $691.5 million to financing purchase contracts through the sale of participation certificates to private investors, at rates ranging from 7.15 to 8.125 percent. The comparable Treasury rates were about three-fourths of a percent less than the effective interest rates for the certificates. Therefore, by financing with participation certificates the Government will incur about $104 to $117 million additional interest costs while the certificates are outstanding.

Apart from higher financing costs, GSA pays real estate taxes until the Government takes title to the purchase contract buildings. Real estate taxes are not paid on Government-owned buildings.

We could not fully compare the overall costs of federally constructed buildings (either direct Federal construction or purchase contract) with leasing because of differences in both the quality and the cost of the buildings.

BUDGETARY IMPACT AND LOCAL REAL ESTATE TAXES

Except for its impact on the budget in the year that construction funds must be provided, direct Federal construction is the most advantageous alternative for financing space acquisition. However, since only limited funds have been available either through direct appropriation or from the Fund, purchase contracting may be the most practicable alternative currently available. While purchase contracting requires several more years than direct Federal construction before generating a budget surplus for the Federal Buildings Fund, it has a much more favorable long-range budgetary impact than leasing.

We analyzed Federal Buildings Fund cash receipts and outlays under direct Federal construction, purchase contracting, and leasing. Our analysis shows that:

--During the early years of building life, only leasing provides a positive cash flow (receipts in excess of outlays) for the Federal Buildings Fund.

--Beyond the early years of building life, direct Federal construction provides the largest cumulative cash flow for the Federal Buildings Fund.

--Over the entire building life, purchase contracting provides a substantially larger cumulative cash flow than leasing, and direct Federal construction provides a larger cumulative cash flow than either leasing or purchase contracting.

Local real estate taxes on purchase contract projects are a substantial drain on Federal Buildings Fund resources. The taxes on purchase contract buildings of $1.3 billion represents about 30 percent of the Fund's liability for purchase contract payments. Local tax payments have an adverse impact on the Fund's ability to generate money for new construction. If additional purchase contract or other financing authority were granted with a requirement for the Fund to bear the cost of local real estate taxes, the taxes on new projects would jeopardize the $50 million average annual surplus which the Fund has been providing for construction. If the Federal Buildings Fund is relieved of the cost of real estate taxes, the Fund would be able to generate more money for construction. Relief could be provided through appropriations separate from the Fund expressly for real estate taxes, or by additional appropriations to the Fund to cover tax payments.

On the basis of cost and budgetary impact, direct Federal construction is a more effective way to finance space acquisition than purchase contracting. However, purchase contracting offers several benefits which, when considered in light of the limited funds available for direct Federal construction, can make it a useful financing alternative. We believe that if the Congress wants to provide General Services with a financing alternative to direct Federal construction and leasing, it should limit the agency's financing authority to direct loans from either the Treasury or the Federal Financing Bank.

Borrowing directly from the Treasury or the Bank would preclude debt management problems similar to those reported to the subcommittee in our July 11, 1979, report. In addition certain administrative expenses would be avoided.

In our October 17, 1979, report we recommended that the Congress limit GSA's financing authority to direct loans from the Treasury or the Federal Financing Bank. We also recommended that if the Congress expects that the Government should continue to pay local real estate taxes and that the fund should provide adequate resources for construction, it should offset the adverse impact by making separate appropriations to GSA for taxes or direct appropriations to the Fund to cover tax payments.

Mr. Chairman this concludes my prepared statement. My associates and I will be happy to respond to any questions you or any member of the subcommittee may have at this time.