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COMPTROLLER GENERAL OF THE UNITED STATES

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The Honorable Jennings Randolph
Chairman, Committee on Public Works 53100
United States Senate



Dear Mr. Chairman:

Your April 20, 1973, letter requested that we obtain information and report to your Committee on the interest costs for participation certificates sold by the General Services Administration (GSA), compared with those for Treasury obligations. 17

Section 5 of Public Law 92-313, dated June 16, 1972, authorized GSA for 3 years to make purchase contracts with independent contractors which would finance and construct public buildings to GSA specifications. GSA would make periodic installment payments during the contract period to amortize construction and financing costs. After the contract period, not to exceed 30 years, title to the buildings would transfer to the Government.

In supporting this law GSA asked the Congress in 1971 for purchase contract authority for 3 years as a stopgap expedient for eliminating the backlog of congressionally approved but unfunded Federal construction projects. At that time, GSA listed a backlog of 63 projects, with estimated construction costs of about \$750 million, that could be built under purchase contract arrangements. For various reasons GSA withdrew nine projects from its 1971 list and added another nine projects which the Public Works Committees had approved after Public Law 92-313 had been enacted.

As of March 31, 1973, GSA, under its purchase contract authority, had obtained about \$626.8 million for financing 37 projects consisting of \$104.3 million for 23 projects under a package system and \$522.5 million for 14 projects under a dual system.

Under the package system GSA has contracted with independent contractors, on a competitive-bid basis, for the construction and the financing of the 23 projects. Under the dual system GSA awarded separate contracts, or had awards pending, for construction of the 14 projects and obtained the project

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financing through the sale of 30-year participation certificates by the GSA trustee, the First National City Bank, New York. *P. 2204*

Public Law 92-313 and its legislative history are silent concerning the financing with participation certificates. The Comptroller General has ruled, however, that this method is within the framework of the law. Also, the Attorney General has advised GSA that the certificates are general obligations of the United States, backed by its full faith and credit.

To date GSA has sold three issues of participation certificates amounting to \$522.5 million. The first, amounting to \$196.5 million, was sold in increments from October 30 through November 3, 1972, and had interest rates varying from 7.125 to 7.4 percent; the second, amounting to \$200 million, was sold on December 13, 1972, and had an interest rate of 7.15 percent; and the third, amounting to \$126 million, was sold on March 14, 1973, and had an interest rate of 7.5 percent. (See enclosure.) The issues were sold at a total discount of about \$4.6 million, which resulted in an overall effective interest rate of 7.25 percent on the first and second issues and 7.90 percent on the third issue.

Of the net proceeds of \$517.91 million from the sale of the three issues, \$800,000 has been used to purchase a building site and the balance of \$517.11 million has been deposited in the general account of the Treasurer of the United States in the Federal Reserve Bank of New York. Most of these proceeds, while awaiting use in fulfilling construction requirements, have been invested by GSA in special issues (short-term notes) of the Treasury and have annual interest rates of from 4.8 to 6.9 percent. The interest earned on these funds is less than the rate GSA is required to pay on the participation certificates. At March 31, 1973, \$511.36 million remained with the Treasury after disbursements of \$5.75 million had been made primarily to contractors.

On the basis of market conditions at the time GSA participation certificates were issued, we estimated that the Treasury could have issued long-term Government bonds for about 3/4 of 1 percent less than the effective interest rate for the certificates. The additional interest costs associated with the \$522.5 million of participation certificates is about \$3.92 million a year, which amounts to \$117.6 million for the 30-year term.

Because of the potential interest savings that would be possible by financing the GSA purchase contract program through Treasury borrowings, our February 27, 1973, letter to the

Acting Administrator of General Services suggested that GSA consider seeking a change in the law that would provide for the remaining financing by direct Treasury borrowings.

By letter dated March 13, 1973, GSA concurred with us that direct Treasury borrowings would be more economical than participation certificates or the variety of financing methods used by certain other Federal agencies. GSA stated that, to remedy the problem, the Administration has sponsored the proposed Federal Financing Bank Act of 1973. GSA stated that enactment of this proposed legislation (S. 925, Feb. 20, 1973) is intended to accomplish the objectives we proposed for GSA; it will accomplish the same objective for other Federal agencies as well.

The legislation to establish a Federal Financing Bank was first introduced in the Senate as Senate bill 3001 on December 13, 1971, and was passed on October 16, 1972. An amended version was reported on favorably by the Committee on Ways and Means, House of Representatives, but it was not taken up on the House floor before the 92d Congress adjourned.

Senate bill 925, introduced in the Senate on February 20, 1973, is similar to Senate bill 3001. Its purpose is to (1) assure coordination of the financing needs of Federal and federally assisted borrowing programs with overall economic and fiscal policies of the Government, (2) reduce the costs of Federal and federally assisted borrowings from the public, and (3) assure that such borrowings are financed in a manner least disruptive to the private financial markets and institutions.

A Federal Financing Bank would be established to carry out the legislation. The bank would be subject to the general supervision and direction of the Secretary of the Treasury. Federal agencies would be required to submit their financing plans for approval to the Secretary of the Treasury, who would be the Chairman of the bank's Board of Directors.

Since we brought this matter to its attention, GSA has sold \$126 million of participation certificates and is scheduled to sell two more issues to finance the remaining 26 projects. The first of these 2 issues, covering 23 projects, is scheduled for July 1973; the other, covering 3 projects, is scheduled for March 1974.

We do not believe that enacting the proposed legislation would result in any sizable savings for GSA because it would have sold most, if not all, of its participation certificates before the proposed legislation could be enacted and implemented.

GSA has not estimated the financing required for the two scheduled issues. According to GSA records the estimated construction costs are \$294 million for the 23 projects and \$67 million for the 3 projects. If GSA follows its practice, it will obtain financing in excess of construction costs of \$361 million to cover (\$294 million plus \$67 million) (1) incurred interest expense on the participation certificates and real estate taxes during the construction period, (2) cost escalation, and (3) certain other costs.

Two features of the proposed legislation may affect interest savings on any GSA financing remaining at the time of passage. First, according to Senate Report 92-853 on Senate bill 3001, dated June 12, 1972, the proposed legislation would not require the bank to lend to any agency nor require any agency to borrow from the bank. Therefore, even if the legislation is passed, GSA could, with the approval of the Secretary of the Treasury, continue to sell its participation certificates to the public. Secondly, interest on GSA's certificates and Treasury obligations is not subject to State and local income taxes; under Senate bill 925, interest on the proposed bank securities would be. This would tend to increase the interest rate on the bank's securities.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,



Comptroller General
of the United States

Enclosure

SCHEDULE OF FINANCING BY GSA THROUGH SALE OF
PARTICIPATION CERTIFICATES AS OF MARCH 31, 1973

	Principal amount	Sales price expressed as a percentage of principal amount	Sales price (net proceeds)	Discount amount	Annual interest rate (percent)	Annual interest cost
First issue, 10-30-72 to 11-3-72:						
Series A	\$ 65,300,000	99.411	\$ 64,915,383	\$ 384,617	7.4	\$ 4,832,200
Series B	48,800,000	98.51	48,072,880	727,120	7.3	3,562,400
Series C	25,100,000	98.93999	24,833,938	266,062	7.25	1,819,750
Series D	22,700,000	98.601	22,382,427	317,573	7.2	1,634,400
Series E	<u>34,600,000</u>	98.8599	<u>34,205,525</u>	<u>394,475</u>	7.125	<u>2,465,250</u>
	196,500,000		194,410,153	2,089,847		14,314,000
Second issue, 10-13-72:						
Series F	200,000,000	99.5299	199,059,800	940,200	7.15	14,300,000
Third issue, 3-14-73:						
Series G	<u>126,000,000</u>	98.761	<u>124,438,860</u>	<u>1,561,140</u>	7.50	<u>9,450,000</u>
Total	<u>\$522,500,000</u>		<u>\$517,908,813</u>	<u>\$4,591,187</u>		<u>\$38,064,000</u>