

REPORT BY THE

Comptroller General

OF THE UNITED STATES

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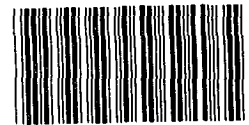
General Services Administration's Debt Management Problems With Its Participation Certificates

The General Services Administration obtained \$697.1 million through the sale of its 30 year participation certificates, issued under four trust indentures. It has experienced problems complying with the terms of the indentures relating to (1) the use of market purchases as a credit against mandatory annual redemptions and (2) the incorrect computation of installments for annual redemptions.

In 1979 the trustee issued "event of default" notices for two indentures because about \$7 million of certificates were not redeemed to meet mandatory sinking fund installments in 1976, 1977, and 1978. General Services deposited funds with the trustee to cover the shortages disclosed to date in an effort to cure the claimed defaults.

In the event of default, the trustee or holders of 25 percent of the outstanding certificates may declare the entire amount of certificates due and payable immediately. As of June 21, 1979, this had not been done.

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Debt held by public
Loan defaults
Trust funds
Treasury management
Payments
Government facility construction



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON DC 20548

B-95136

The Honorable Elliott H. Levitas
Chairman, Subcommittee on Public
Buildings and Grounds
Committee on Public Works
and Transportation
House of Representatives

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Dear Mr. Chairman:

On March 19, 1979, you asked us to provide information on the problems the General Services Administration is having in the debt management of participation certificates. These certificates were sold to finance certain buildings under the 1972 purchase contract authority, contained in Public Law 92-313. You asked specific questions designed to augment our testimony of February 27, 1979, before the Subcommittee on this matter. As discussed with your office, this report does not contain any conclusions about the validity of General Services' claims that the trustee improperly used trust funds to purchase certificates because the matter is in litigation.

Details on eight of the nine questions are included in appendix I; the ninth question on our observations and recommendations is discussed below.

OBSERVATIONS

General Services has experienced problems with the administration of the indentures relating to (1) the use of open market purchases as a credit against mandatory annual redemptions and (2) the incorrect computation of installments for annual sinking fund redemptions. The trustee notified certificate holders in January and March 1979 that sufficient certificates were not redeemed as required by two indentures. The combined shortage was \$7.215 million. General Services deposited funds with the trustee to cover this shortage. As provided in the indentures, in the event of default, the trustee or holders of 25 percent of the outstanding certificates, may declare the entire principal amount of certificates due and payable immediately. As of June 21, 1979, this had not been done.

If the \$374 million of outstanding certificates that the trustee declared in default were accelerated today and refinanced, it would cost the Government extra interest of about \$7.5 million the first year. Although the Government does not believe that a right to accelerate exists, it would be beneficial to the certificate holders to have certificates declared due and payable now at par because certificate interest rates are about 2 percentage points below the current Department of the Treasury rates and the certificates trade at sizable discounts from par.

The incorrect computation of the annual installments occurred because these computations were based on a percentage of the face amount of certificates rather than on the principal amount of purchase price, which included certificate proceeds and interest earned thereon. In January 1979 General Services made initial computations of the principal amount of the purchase price for each indenture, and additional certificates were redeemed to cover prior year shortages based on that calculation. General Services revised these computations in June 1979 and the principal amount of the purchase price was increased about \$3 million for the four indentures. Since there is a higher base for calculating redemptions, additional certificates will have to be redeemed to cover prior year shortages.

In February 1979 the responsibility for financial management and accounting for the program was transferred from the General Services' Public Buildings Service to the Office of Controller-Administration. This office has expertise in financial management, but it has no prior expertise with security debt management. Future debt management should be routine for the most part because the problems which have been identified, when resolved, should not be recurring.

We believe that the overall responsibility for debt management should be vested in one top agency official, such as the Controller, who would be responsible for transactions relating to debt management of General Services' participation certificates. In the past many major decisions were made by lower level personnel without review and approval by higher level agency officials. These officials believed that the trustee was responsible for reviewing transactions but they did not monitor trustee performance.

General Services can make market purchases to meet annual sinking fund requirements for certificates issued

under three indentures. When certificates sell below par, the Government will save money by purchasing the certificates rather than redeeming them at par. The timing of such purchases is an important decision which should be assigned to a top agency official. Due to the uncertainties and complexities of the market, General Services could draw upon the experience and expertise of the Treasury Department before making market purchases.

Another procedure that should be adopted is a requirement for the independent verification of periodic principal and interest payments. This task could be performed either by the agency or by the trustee. In the past General Services assumed the trustee made such verifications, but it had no assurance that it was being done.

The Farmers Home Administration has a program similar to General Services participation certificate financing. Farmers Home Administration acts as its own trustee for its debt obligations. Principal and interest payment computations are verified within the agency. In addition there is an external verification procedure performed by the Bureau of Public Debt.

RECOMMENDATIONS

The Administrator of General Services should:

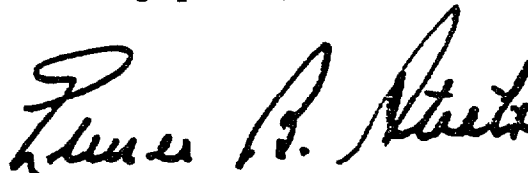
- Adopt a procedure providing for the independent verification of principal and interest payments. This procedure could be accomplished either by the agency or by the trustee.
- Require that a top agency official be assigned the responsibility for decisions relative to market purchases. This official could obtain the advice of the Treasury Department which has expertise in this area.

AGENCY COMMENTS

This report was not submitted to General Services for written comment. A draft was discussed with agency officials. These officials are of the opinion that the recommendations should be adopted.

As arranged with your office, we are sending copies of this report to the Administrator of General Services. Unless you publicly announce its contents earlier, no further distribution of this report will be made until 10 days from the date of the report.

Sincerely yours,

A handwritten signature in cursive script, reading "James B. Street". The signature is written in black ink and is positioned above the typed name.

Comptroller General
of the United States

PROBLEMS RELATING TO COMPLIANCE WITH
THE TERMS OF VARIOUS GENERAL
SERVICES ADMINISTRATION TRUST INDENTURES

INTRODUCTION

Section 5 of Public Law 92-313, dated June 16, 1972, authorized the General Services Administration (GSA) for 3 years to acquire new Federal buildings through purchase contract agreements with independent contractors which would finance and construct buildings to GSA's specifications. GSA would make periodic payments during the contract periods to amortize construction and financing costs and to pay other costs, including real estate taxes. At the end of the contract period, not to exceed 30 years, title to the buildings would transfer to the Government. The purpose of this law was to eliminate a backlog of needed Federal buildings without the necessity for making large initial appropriations for capital expenditures.

Utilizing this legislation, GSA employed two methods to obtain about \$1.369 billion for the construction of 68 buildings containing about 15 million square feet of occupiable space.

Under a package system, GSA entered into agreements with contractors for the construction and the financing, about \$138.2 million, of 23 small building projects. GSA makes semiannual payments to the contractors for interest, real estate taxes, and amortization of principal. At the end of the 30-year contract period, title to the buildings vests with the Government.

Under a dual system GSA contracted separately for the construction and the financing of 45 building projects. Financing of \$697.1 million was obtained through the sale of participation certificates and about \$534 million was borrowed from the Federal Financing Bank. The construction contracting, under the dual system, was done in the same way as under direct Federal construction using appropriated funds.

Participation certificates were issued under four trust indentures at interest rates ranging from 7.15 to 8.2 percent.

(See app. II.) The indentures cover 10 certificate issues known as series A through J. Series A through I were purchased by private investors and series J, by the Federal Financing Bank.

The net proceeds, after discounts of \$5.76 million, from the sale of the certificates were \$691.35 million. GSA invested most of the proceeds, while awaiting use in meeting construction obligations, in Treasury Department short-term notes. These notes were at interest rates which were below the rate GSA was required to pay on its certificates.

The First National City Bank (Citibank) acts as trustee under each indenture. It pays interest and principal to certificate holders and construction costs and other expenses to contractors.

Certificates are subject to annual redemption. Under a mandatory sinking fund, a percentage of the certificates is redeemed annually.

The four indenture provisions are similar except that under three indentures, covering series F through I, it is possible to make open market purchases to meet the annual sinking fund requirements. When the certificates sell below par, it will be to the Government's advantage to make open market purchases. ^{1/} This option is limited in the first indenture covering series A through E in that appropriated funds may not be used for such purchases.

According to each indenture, the proceeds were to be credited initially to a construction fund and to a debt service fund which pays project construction, interest during construction, and other costs specified in the indenture. When certain events occurred as described in the indenture, balances not required for construction could be used by the trustee to purchase certificates in the private market. These purchases could, according to the indenture,

^{1/}This point applies only to market purchases below par to satisfy the annual mandatory redemption requirements, as permitted by three indentures. The Government would not necessarily save in purchasing certificates below par, when not required for mandatory redemptions, because the Treasury Department has in effect to borrow at a higher interest rate to make these purchases.

be credited against the next maturing mandatory sinking fund installments.

The mandatory sinking fund percentage for each indenture was to be based on the "principal amount of the purchase price" and not on the amount of certificates sold. The term principal amount of the purchase price is defined in the indentures to mean the amount paid by the trustee from the construction and debt service funds and any other amount transferred from the construction fund to the completion fund.

As stated previously, most of the proceeds from the sale of the certificates were invested in short-term Treasury notes and earned interest while awaiting disbursement on construction contracts. This earned income was credited to the construction fund. Therefore, the amounts credited to the construction and debt service funds exceeded the amount of the certificates sold. For example, GSA sold \$196.5 million of certificates under the first indenture, series A through E, and calculated the principal amount of the purchase price in January 1979 to be \$211.8 million.

| | |
|--|-------------------------|
| Payments from the construction fund | \$129,646,780.16 |
| Transferred from the construction fund to the completion fund on August 12, 1975 | 42,869,958.37 |
| Deposited to the debt service fund to pay interest during construction | <u>39,283,977.92</u> |
| | <u>\$211,800,716.45</u> |

PROBLEMS WITH THE
ADMINISTRATION OF INDENTURES

GSA has experienced problems with the administration of the four trust indentures relating to (1) the use of credits for open market purchases against mandatory redemptions and (2) the incorrect computations of installments for annual sinking fund redemptions. In January and March 1979, the trustee issued notices of "event of default" for two indentures because sufficient certificates were not redeemed to meet annual sinking fund installments.

1st indenture, series A through E

On January 2, 1979, the Puritan Fund, Inc., owner of \$17,640,000 of certificates, series A through E, notified the trustee and GSA that the Government failed to pay its November 1, 1978, mandatory sinking fund installment and that the credit claimed for prior purchases could not be applied against this installment. The Puritan Fund contended that the purchases had to be claimed as a credit against the next sinking fund installment occurring more than 45 days after such purchase and cancellation; the credit could have been applied to the November 1, 1977, installment.

In January 1979 the trustee found that in addition to the question about using credits for prior purchases, the annual redemptions for series A through E were computed incorrectly. The trustee notified the holders of the participation certificates by letter dated January 29, 1979, that the Government was not properly entitled to a credit against the mandatory installment due October 31, 1978, for certificates previously purchased by the trustee. The trustee also indicated that the mandatory redemptions were short in 1976 by \$190,000 and in 1977 by \$225,000. The trustee stated that each failure to pay installments in cash became an event of default. GSA does not agree that there was a default.

As provided in the indenture, in the event of default the trustee or holders of 25 percent of the outstanding certificates may, by notice in writing to the contracting officer, declare the entire outstanding certificates due and payable immediately. It would be beneficial to the certificate holders to have the series declared due and payable at par because the certificates sell at a sizable discount from par and pay interest that is about 2 percentage points below current Treasury rates.

The trustee did not declare the entire principal amount of certificates due and payable immediately, but indicated that he would evaluate information to determine the appropriate course of action. The trustee stated that sufficient cash was deposited with the trustee to make necessary mandatory redemptions. GSA transferred \$4.1 million to the trustee in January 1979. It is GSA's position that it cured the default claimed by the trustee.

On January 31, 1979, the trustee issued a redemption notice of \$3,595,000 of participation certificates as follows.

| | |
|-------------------------------|--------------------|
| November 1, 1978, entire call | \$3,180,000 |
| November 1, 1977, shortage | 225,000 |
| November 1, 1976, shortage | <u>190,000</u> |
| Total | <u>\$3,595,000</u> |

The shortage in 1976 and 1977 was due to an error in computing the mandatory installment on the face amount of the issue (\$196.5 million) rather than on a percentage of the principal amount of the purchase price (\$211.8 million) as follows:

| <u>Year</u> | <u>Annual percentage</u> | <u>Annual installment</u> | |
|-------------|--------------------------|--------------------------------------|--------------------------------------|
| | | <u>Calculated on \$196.5 million</u> | <u>Calculated on \$211.8 million</u> |
| 1976 | 1.25 | \$2,456,250 | \$2,647,509 |
| 1977 | 1.50 | 2,947,500 | 3,177,011 |
| 1978 | 1.50 | 2,947,500 | 3,177,011 |

Since \$5,000 was the lowest denomination for certificates, the annual redemption is the multiple of \$5,000 which would most fully utilize the installment amount.

To meet the mandatory sinking fund redemptions on November 1 of each year, the following actions were taken.

| | |
|--|--------------------|
| 1976 Redeemed at par | \$1,255,000 |
| Credit for market purchases made by the trustee | <u>1,200,000</u> |
| Total | <u>\$2,455,000</u> |
| 1977 Redeemed at par | <u>\$2,950,000</u> |
| 1978 Credit for prior market purchases made by trustee | <u>\$2,945,000</u> |

2d indenture, series F

On March 14, 1979, the trustee notified the certificate holders of series F that sufficient certificates were not redeemed to meet the mandatory sinking fund installments in 1976, 1977, and 1978. The combined shortage was \$3,620,000. According to the trustee, failure to pay the installments became an event of default.

In January, February, and March 1979, GSA deposited sufficient funds with the trustee to make the redemption. GSA contends that the redemptions could have been avoided altogether had the trustee applied funds onhand prior to October 15, 1976, and made purchases of outstanding certificates. Purchases made by the trustee prior to October 15, 1976, could have been credited against 1976, 1977, and 1978 redemptions, but the trustee made purchases of \$5.28 million after the deadline.

On March 15, 1979, the trustee issued a redemption notice for \$3.62 million of series F certificates as follows

| | |
|----------------------------|--------------------|
| Dec. 15, 1978, entire call | \$3,315,000 |
| Dec. 15, 1977, shortage | 45,000 |
| Dec. 15, 1976, shortage | <u>260,000</u> |
| Total | <u>\$3,620,000</u> |

To fully compensate the certificate holders, the Government agreed to pay interest on the \$3,620,000 at 9.35 percent from December 15, 1978, to the redemption date. Also, on series A through E the Government agreed to pay interest on the \$3,595,000 of certificates at 9.3 percent from November 1, 1978, to the redemption date. The rate for the shortfall periods was based on the yield on Treasury securities with comparable periods of maturity which was about 2 percentage points more than the yield on the participation certificates.

GSA contends that the trustee did not comply with the provisions of the indentures for series F through I. According to GSA, the trustee used about \$18.56 million of trust funds to make market purchases for the Government's account, instead of applying these funds to redeem participation certificates at specified premiums. In March 1979 the Government filed actions in the Southern District Court of New York to recover any funds misapplied by the trustee.

Recomputation of financial transactions

The initial computation of the principal amount of the purchase price made by GSA in January 1979 will have to be revised for each of the indentures. The amount of Treasury securities (short-term notes) in the construction fund at the target completion date was transferred to the completion fund at cost and not at market value as provided in the indentures. For example, the indenture for the A through E series states that:

"At the Target Completion Date, if the construction of any Projects has not been completed, the Government may by Request direct that some or all of the moneys or Investment Securities remaining in the Construction Fund be transferred therefrom and credited by the Trustee to the Completion Fund. The request under this Section 2.05 shall include a certification by the Contracting Officer that the aggregate amount of moneys or Investment Securities (at the fair market value thereof) to be so transferred and credited does not exceed the maximum amount of moneys then estimated by the Government in good faith to be required to cover the Construction Costs and Administrative Costs applicable to completion of construction of Projects not completed at the Target Completion Date * * *."

In April 1979 GSA awarded a contract to a certified public accounting firm to reconstruct the financial transactions under the four trust indentures. The firm was to recompute the principal amount of the purchase price as defined in each indenture from the GSA and trustee records. At the completion of our fieldwork in June 1979, the firm had not completed its work. On June 25, 1979, GSA officials told us that its revised calculations increased the principal amount of the purchase price by about \$3 million for the four indentures. As a result of the higher base for calculating redemptions, additional certificates will have to be redeemed to cover prior year shortages.

Our comments on the questions relating to participation certificates appear below. (See app. IV.)

Questions 1 and 2: Were the selections of the special counsel, the financial advisor, and trustee made in accordance with existing regulations and practices? In addition, how,

by whom, and with what criteria were
the selections made?

GSA awarded nine contracts costing about \$1.46 million for legal, financial, and trustee services associated with the four trust indentures. (See app. III.) These contracts were negotiated pursuant to the authority contained in section 302 (c)(4) of the Federal Property and Administrative Services Act of 1949, as amended (41 U.S.C. 252), which allows the agency head to negotiate contracts without advertising "for personal or professional services."

GSA records did not provide us with sufficient information on all contracts to determine how, by whom, and with what criteria (other than the legal provision cited above), the selections were made. In addition, GSA officials associated with the contract selections, negotiations, and award are no longer with the agency. One individual who was involved in all facets of the purchase contract program is deceased.

Special counsel--\$524,392.85

The special counsel was the firm of Reed, Smith, Shaw, and McClay of Pittsburgh, Pennsylvania. GSA awarded four contracts, which appear to have been on a sole-source basis, to the special counsel. GSA's files did not indicate (1) if any other firm was considered for these contracts or (2) who selected the special counsel.

Financial advisor--\$658,120.81

Kidder, Peabody, and Company, Inc., was selected by the then Administrator, Mr. Arthur F. Sampson, to act as financial advisor. The contract for series A through E was for a fixed fee of one-eighth of 1 percent of the face value of the issue. The contract was amended to include series F through I with a reduced fee of one-twelfth of 1 percent of the face value of each issue. There is no evidence that any other firm was considered.

Trustee--\$276,159.58

Four contracts were awarded to Citibank to serve as and perform the duties and functions of the trustee under the indentures. The financial advisor recommended several organizations, including Citibank to act as trustee. These organizations were required to submit proposals. In each instance

Citibank submitted the lowest responsive offer and, therefore, was selected. A listing of GSA's analysis of responses for the first contract follows.

| <u>Offeror</u> | <u>Initial fee</u> | <u>Present value of annual fees</u> | <u>Total</u> |
|--|------------------------|---|--------------|
| American Security and Trust Company | \$ 7,850 | \$124,694 | \$132,544 |
| Mellon National Bank and Trust Company | 38,000 | 111,634 | 149,634 |
| Citibank | 11,950 | 99,352 | 111,302 |
| Chase Manhattan Bank, N.A. | 28,250 | 194,820 | 223,070 |
| Bank of America National Trust and Savings Association | 15,050 | 151,037 | 166,087 |

Question 3: Was the trust indenture prepared in accordance with generally accepted legal practices for other types of indentures? Did it contain common or "boiler plate" provisions for (a) determining principal and interest payments and (b) determining, notifying, and curing defaults?

The GSA participation certificate financing has many features which are similar to revenue bond financing used by local governments. Both methods use an indenture document setting forth the conditions under which the securities are issued. It is an accepted practice in municipal bond financing to have a recognized bond counsel prepare an opinion with respect to bond offering in order to give assurance to investors and investment bankers that the securities being marketed are valid. The 1977 "Directory of Municipal Bond Dealers of the United States" lists about 230 law firms that issue opinions in connection with the sale of State and municipal bonds. The GSA special counsel, Reed, Smith, Shaw, and McClay, is included in the 1977 directory.

The four GSA indentures were prepared by the special counsel, with the aid of GSA officials, the financial advisor and his counsel, and the trustee and his counsel.

Parts of the indenture were reviewed by the Securities and Exchange Commission and the Treasury Department. Although indenture provisions vary, many of the covenants contained in the GSA indentures are included in revenue bond indentures, such as duties and responsibilities of the trustee, redemption of securities, including retirement and refunding prior to maturity, use of the proceeds, and payment of interest. In some respects, each GSA indenture was a nonstandard document.

Some revenue bonds are backed by a dual pledge to repay the indebtedness. The full faith and credit of the issuing government is pledged, as well as the revenues from the facility financed with the bond proceeds. Likewise, the GSA certificates contain a dual pledge. They are general obligations of the United States, backed by its full faith and credit. In addition, the certificates are secured by the projects constructed with the proceeds from the sale of certificates. Title to the projects is vested in the trustee for the benefit of the investors until the certificates are paid. In the event of default, the trustee may take possession of the building projects and collect rent.

The GSA indentures were written in such a way that funds not needed to complete a project would be returned to investors by redemption of certificates and thereby reduce the indebtedness so that the Government's liability would not exceed the cost of the projects. In other words, the face amount of the indebtedness would be reduced to equal the purchase price of the capital investment at a collapse date. To have the value of the projects equal or exceed the outstanding amount of the bond issue is added protection for investors in the event of default.

As stated previously, the cost of acquiring the projects (purchase price) included (1) interest paid (capitalized interest) during the construction period, (2) payments to contractors from the construction fund, and (3) transfers from the construction fund to the completion fund. The construction fund was credited with the proceeds from the sale of certificates and with interest earned on these proceeds while awaiting disbursement. Since sizable amounts of interest was earned on all issues and was available to apply towards the cost of acquiring projects, the purchase price under each indenture exceeded the face amount of the securities sold. The indentures did not specifically require that interest earned be credited to the construction fund.

In the case of revenue bonds, interest earned on invested funds may be credited to the fund from which invested, used to retire bonds, or included in gross revenues. With respect to interest paid during the construction period, it is a common practice to include it as part of the cost of the facility.

Officials at Treasury, GSA, and Securities and Exchange Commission (SEC) expressed the opinion that the indenture clauses relating to determining, notifying, and curing defaults were normal by industry standards. The degree to which they are spelled out varies. According to the officials, in retrospect, it would have been better to have detailed the cure methods. However, the drafters of the indentures did not give any thought to the possibility of the Government defaulting.

According to the Special Counsel (GSA Bond Counsel), GSA, and SEC, the indentures were complicated because of the way the law was written.

Several provisions were added to accommodate pledging the projects as security for the indebtedness. These provisions require expert financial management attention in order to meet the legal and financial requirements of the indenture.

Question 4: Where, within the GSA, was the daily responsibility for the financial management of the Purchase Contract program? How was that office organized and did it possess adequate experience, expertise, and resources to do the job?

Originally the debt management was handled by a special assistant to the Executive Director, Public Buildings Service (PBS), who reported directly to the Commissioner's office. The special assistant was on the task force which set up the sale of the series A through E and he had helped develop the indentures related to series A through I. This assistant had a degree in law and had been working in budget and financial planning for about 6 years before assuming responsibility for financial management of the certificates. He was reassigned prior to the first scheduled redemption in 1976 and, hence, was not involved in computing any mandatory redemption amounts.

When the special assistant was reassigned in early 1974, the debt management was delegated to a budget analyst in the

Financial Management Division, Office of the Executive Director, PBS. The first analyst in the Division was trained by the special assistant, had a B A. degree in mathematics and an M.B.A. in finance, and had experience in the military and in GSA financial programs. The second analyst, who took over in September 1977, was trained by his predecessor, had a B.S. degree in business administration and had been a budget analyst since joining GSA in July 1972.

Neither the special assistant nor the budget analysts had any prior experience with security debt management. However, it appears that with a background in law and finance and having aided in developing the indentures, the special assistant was better qualified to handle debt management than his successors

Originally the Commissioner, PBS, approved all requests for disbursements of trust funds. In September 1973 this authority was delegated to the Executive Director, PBS, who in turn delegated it to the special assistant. When the special assistant was reassigned in 1974, the Executive Director resumed approval for a period and then assigned it to the Director of the Financial Management Division, Executive Director's office.

GSA procedures required that principal and interest disbursement requests be processed through the Office of Finance, Office of Administration--now the Office of Controller-Administration. However, that organization did not check the accuracy of the disbursements. The apparent reason for the lack of an in-house verification of principal and interest computations was that GSA believed the trustee, who was considered to have the expertise, would perform an accuracy check.

Question 5: Was any other unit within GSA better suited and/or have the experience and expertise to handle bond repayment administration in 1972?

We do not believe that any other organizational unit was better suited for handling bond administration than the Executive Director's office, PBS. The logical place to assign the responsibility for debt management in a company is to the treasurer or controller's office. In 1972 the comparable office in GSA was the Office of Finance, within the Office of Administration, but the Office of Finance had no prior experience or expertise in the administration of securities. It could have assumed the responsibility for

the financial management of the certificates. However, in 1972 it appeared that PBS had more experience since it was involved in the development of the indentures and in the sale of the certificates.

Question 6: Where, within the agency, is responsibility currently placed, and does the unit possess sufficient experience and expertise to properly manage the program?

In February 1979 the responsibility for the financial management and accounting for the program was transferred from the Executive Director, PBS, to the Office of Controller-Administration. The task of debt management has been further delegated downwards within the latter organization to the Chief, Credit and Finance Branch, Financial Management Division, Office of Finance. This seems to be a logical change since the Office of Controller-Administration has expertise in financial management. However, this organization has no prior experience with security debt management. When GSA and the trustee agree on the computation of the principal amount of the purchase price for each indenture, future debt management transactions should be routine for the most part. The availability of excess proceeds for open market purchases was a one-time event and is not recurring.

GSA officials state that while the day-to-day operations are carried out by the Credit and Finance Branch, signature authority was not delegated downward. Signature authority remains with the Director, Office of Finance, Office of Controller-Administration.

Question 7: What general observations and recommendations would you make regarding the proper management of this program?

Our observations and recommendations are included in the transmittal letter to this report.

SERIES F, G, H, and I

Question 1: Were series F through I drafted and administered in a similar fashion as A through E? If not, address the differences and whether the Government will be faced with future problems with respect to default.

Series F through I were drafted and administered in a similar fashion to series A through E. As stated previously, one of the principal differences is that the Government can make open market purchases with appropriated funds under series F through I to meet the annual sinking fund requirements. This option is not available under series A through E. This option is advantageous when certificates are selling at a discount.

When GSA and the trustee agree on the computation of the principal amount of the purchase price and law suits are resolved, there should be no default problems and future debt management should be routine.

Question 2 With regards to accusations raised against the trustee by GSA in its press release of March 15, 1979, would you provide an analysis of each governmental claim and your appraisal of the factual reliability of the assertions.

GSA contends that the trustee misapplied \$18.56 million in trust funds by making open market purchases which could not be credited against mandatory redemptions. The second, third, and fourth indentures authorize the trustee to transfer funds from the construction fund to make open market purchases prior to a specified date. However, contrary to the indenture provisions, the trustee, according to GSA, used funds after the specified date to make open market purchases. Therefore since the purchases were made after the deadline, they could not be applied as a credit against mandatory redemptions. Series F was in default because ineligible credits were used for mandatory redemptions.

GSA claims the fault lies with the trustee in that, in accordance with the indenture, the use of excess funds for open market purchases was the responsibility of the trustee without any action required of the Government. The trustee denies responsibility. He contends that the details of the transactions and the cancellation of certificates were reported to GSA.

This matter is now in litigation. It is our policy not to comment on issues in litigation so as to avoid the possibility of prejudicing the outcome.

GENERAL SERVICES ADMINISTRATION
LISTING OF PARTICIPATION CERTIFICATES

| <u>Indenture</u> | <u>Date</u> | <u>Series</u> | <u>Face amount</u> | <u>Sales price (net proceeds)</u> | <u>Discount</u> | <u>Annual interest rate</u> |
|------------------|-----------------|---------------|----------------------|-----------------------------------|--------------------|-----------------------------|
| First | Nov. 6, 1972 | A thru E | \$196,500,000 | \$194,410,153 | \$2,089,847 | a/7.284 |
| Second | Dec. 18, 1972 | F | 200,000,000 | 199,059,800 | 940,200 | 7.150 |
| Third | Mar. 21, 1973 | G | <u>126,000,000</u> | <u>124,438,860</u> | <u>1,561,140</u> | 7.500 |
| | | | <u>522,500,000</u> | <u>517,908,813</u> | <u>4,591,187</u> | |
| Fourth | Aug. 1, 1973 | H | 71,000,000 | 70,699,101 | 300,899 | 8.100 |
| | b/Jan. 23, 1974 | I | 98,000,000 | 97,128,780 | 871,220 | 8.125 |
| | b/Feb 27, 1976 | J | <u>5,610,000</u> | <u>5,610,000</u> | <u>-</u> | 8.200 |
| | | | <u>174,610,000</u> | <u>173,437,881</u> | <u>1,172,119</u> | |
| Total | | | <u>\$697,110,000</u> | <u>\$691,346,694</u> | <u>\$5,763,306</u> | |

a/Weighted average range from 7.125 to 7.4.

b/Series I and J are supplements to the fourth indenture Series J was sold to the Federal Financing Bank.

CONTRACT COSTS BY INDENTURE SERIES

| <u>Service and contractor</u> | <u>A-E</u> | <u>F</u> | <u>G</u> | <u>H-J</u> | <u>Total cost</u> |
|---------------------------------|---------------------|---------------------|---------------------|---------------------|-----------------------|
| <u>SPECIAL COUNSEL</u> | | | | | |
| Reed, Smith, Shaw, & McClay | \$135,524.63 | \$103,589.04 | \$ 82,034.74 | \$203,244.45 | \$ 524,392.85 |
| <u>FINANCIAL ADVISOR</u> | | | | | |
| Kidder, Peabody, & Company, Inc | 245,625.00 | 166,666.67 | 104,995.80 | 140,833.34 | 658,120.81 |
| <u>TRUSTEE</u> | | | | | |
| Citibank | <u>108,042.96</u> | <u>73,016.91</u> | <u>34,785.51</u> | <u>60,314.20</u> | <u>276,159.58</u> |
| Total | <u>\$489,192.59</u> | <u>\$343,272.62</u> | <u>\$221,816.04</u> | <u>\$404,391.99</u> | <u>\$1,458,673.24</u> |

HAROLD T (BIZZ) JOHNSON CALIF CHAI N
 RAY ROBERTS TEX
 JAMES J HOWARD N J
 GLENN M ANDERSON CALIF
 ROBERT A ROE N J
 TENO RONCALIO WYO
 MIKE MC CORMACK WASH
 JOHN B BREAUX LA
 BO GINN GA
 DALE MILFORD TEX.
 NORMAN Y MINETA CALIF
 ELLIOTT H LEVITAS GA
 JAMES L OBERSTAR, MINN
 JEROME A AMBRO N Y
 HENRY J NOWAK N Y
 ROBERT W EDGAR PA
 LLOYD TENN
 JOHN G PARY ILL
 TED RISENHOOVER OKLA
 W G (BILL) HEFNER N C.
 DAVID L. CORNWELL, IND
 ROBERT A YOUNG MO
 DAVID E BONIOR MICH
 ALLEN E ERTEL, PA
 BILLY LEE EVANS GA
 RONNIE G FLIPPO ALA
 NICK JOE RAHALL II W VA
 BOB STUMP ARIZ
 DOUGLAS APFLEGATE OHIO

WILLIAM H HARSHA OHIO
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 BUD SHUSTER PA
 WILLIAM F WALSH N Y
 THAD COCHRAN MISS
 JAMES D ABONOR S DAK
 GENE TAYLOR MO
 BARRY M GOLDWATER JR CALIF
 TOM HAGEDORN MINN
 GARY A MYERS PA
 ARLAN STANGELAND MINN
 ROBERT L (BOB) LIVINGSTON LA.

RICHARD J SULLIVAN CHIEF COUNSEL
 LLOYD A RIVARD CHIEF ENGINEER
 LESTER EDELMAN COUNSEL
 LARRY REIDA MINORITY COUNSEL
 ROBERT K DAWSON ADMINISTRATOR

Committee on Public Works and Transportation

Congress of the United States
 House of Representatives

Room 2165, Rayburn House Office Building
 Washington, D C 20515

TELEPHONE: AREA CODE 202 225-4472

March 19, 1979

Honorable Elmer B. Staats
 Comptroller General of the United States
 General Accounting Office
 441 G Street, N. W.
 Washington, D. C. 20548

Dear Mr. Staats

This will confirm the requests made to Messrs. Normile, Maguire and Smarrelli at our February 27, 1979 hearing regarding the General Services Administration's management of Series A through E of the Participation Certificates issued to finance certain buildings constructed under the 1972 Purchase Contract Authority.

As I mentioned during the hearing, we are holding the record open for receipt of further material from your staff with regard to an audit of the expertise and ability of people at the General Services Administration who were charged with the responsibility of managing this financial arrangement. Specifically, I would like answers to the following questions provided for the record

1. Were the selections of the Special Counsel, the Financial Advisor and the Trustee made in accordance with existing government regulations and practices?
2. In fact, how were the selections made, by whom and with what criteria?
3. Was the trust indenture prepared in accordance with generally accepted legal practices for corporate trust indentures or local governmental trust indentures? Did it contain common or "boiler plate" provisions for (a) determining the amount of principal on interest on which periodic redemption is required, and (b) determining, notifying and curing defaults?
4. Where, within the General Services Administration, was the day-to-day responsibility for the management of the financial aspects of the Purchase Contract program? How was that office organized and what experience, expertise, and resources did that unit possess or have available in handling bond re-payment administration? Was that adequate to do the job?

5 Was any other unit within the General Services better suited to manage this program in 1972? Did any other unit within the Agency have experience and expertise in handling bond repayment administration?

6 Where, within the Agency, is responsibility currently placed? Does this unit possess sufficient experience and expertise to properly manage the program?

7 What general observations and recommendations would you make regarding proper management of this program?

Our discussions at the February 27 hearing addressed only Series A through E. You will find attached a General Services Administration press release dated March 15, 1979, which discusses Series F, G, H, and I Participation Certificates. With regard to these four additional series, would you please respond to the following questions:

1 Were Series F through I drafted and administered in a similar fashion to Series A through E? If not, please address the differences in both the drafting and administration and discuss whether the Government will be faced with any future problems with respect to potential defaults?

2 With regard to the accusations raised against the trustee by the General Services Administration in the aforementioned press release, would you provide an analysis of each Governmental claim and your appraisal of the factual reliability of the assertions?

We would be most appreciative if you could give this request priority as we need it as soon as possible for inclusion in the hearing record. In addition, we may be requesting your staff to present further testimony before this Subcommittee on this program.

Very truly yours,



ELLIOTT H. LEVITAS
Chairman
Subcommittee on Public Buildings
and Grounds

(945169)

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