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DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-202453 DATE: July 13, 1982

MATTER OF: Private Borrower-Private Lender Requirement in Public Works and Economic Development Act of 1965

DIGEST: Economic Development Administration (EDA) does not have authority to implement proposal whereby public lenders would be permitted to purchase guaranteed portion of loans made by private lending institutions to private borrowers under 42 U.S.C. § 3142. Whether purchase of the guaranteed note by the public lender is necessarily contemplated when loan guarantee is initially approved or occurs in the ordinary course of unrestricted secondary market trading, such purchase would violate statutory requirement that EDA can only guarantee loans made by private lending institutions. B-194153, September 6, 1979, is expanded and affirmed.

This decision is in response to a request from Mr. Alfred Meisner--the former Acting General Counsel of the United States Department of Commerce--on behalf of the Economic Development Administration (EDA), for our legal opinion concerning the scope of the "private borrower-private lender" requirement set forth in section 202 of the Public Works and Economic Development Act of 1965, as amended, 42 U.S.C. § 3142.

As explained in EDA's letter, EDA has authority under 42 U.S.C. § 3142(a) to guarantee up to 90 percent of guaranteed loans "made to private borrowers by private lending institutions" for the purpose of fostering economic development in economically depressed areas. EDA is presently considering a proposal to allow the sale of the guaranteed portion of these loans in the "secondary money market." As stated in EDA's letter, once the guaranteed note is sold in the secondary market, the purchaser becomes "the actual if not the direct source of funds for the underlying loan transaction," in effect, the lender. If secondary market sales are not restricted, it is possible, if not likely, that the purchasers of the guaranteed note would not always be a "private lending institution" that could have qualified for a guarantee initially. The specific question presented to us is whether the private lender requirement of the statute "extends to subsequent parties to the loan transaction, such as secondary market purchasers." For the reasons set forth hereafter, we believe that question must be answered affirmatively.

As recognized by EDA, this is not the first time we have considered a question involving the interpretation of the private lender requirement in 42 U.S.C. § 3142. In our opinion B-194153, September 6, 1979, which was written in response to a request from Senator Percy, we considered the legality of a proposed pilot program that was designed to bring new industrial development to several depressed areas in the City of Chicago. In that case, EDA had proposed to implement a program whereby it would guarantee loans made to private borrowers by commercial banks with the guaranteed portion of those loans to be subsequently assigned to the City of Chicago or a trustee designated by the City. Under this proposal, each loan would be represented by two notes—with one note representing a percent of the loan to be fully guaranteed and the other note representing the remaining 10 percent of the loan to be wholly nonguaranteed. The City would finance the purchase of the guaranteed notes with funds raised by the sale of bonds in the "public credit markets." While we upheld the legality of the two-note arrangement, we concluded that the proposed financing arrangement exceeded EDA's existing statutory authority and could therefore not be implemented on the following grounds:

> "***The question is not the validity of the guarantee to the private lending institution that originated the loan, but whether, as contemplated in this proposal, the guarantee can be assigned to an entity that is not private, is not a lending institution and could not have qualified for a guarantee initially. This proposal appenrs to us to be an attempt to accomplish indirectly that which clearly could not be accomplished directly. Since the legislation does not allow EDA to guarantee loans made by a lender other than a 'private lending institution', the proposed financing arrangement which necessarily contemplates from its inception that the sole source of the funds to be covered by EDA's guarantee would be a non-private 'lender', albeit using money it had raised from the private sector, is not in accordance with EDA's statutory authority."

A portion of our September 6, 1979 opinion concerning one aspect of the two note arrangement not relevant to this discussion was subsequently modified in 60 Comp. Gen. 464 (1981).

In arguing that the present proposal is within its statutory authority, EDA maintains that both factually and legally it is "clearly distinguishable" from the situation we considered in the earlier case. First, EDA maintains that our decision disapproving the so-called "Chicago" proposal was based largely on the fact that in that case it was contemplated from the inception of the program and the initial approval of a guarantee that a public lender would purchase the guaranteed note. The involvement of the public lender—the City of Chicago—was "an integral and inevitable part of the proposal." Here, EDA argues that the participation of a nonprivate lender in a secondary

market sale is a "potential event" that is not the "motivating factor" underlying the entire transaction. Therefore, EDA contends that as long as it is unaware of any specific proposal to involve nonprivate lenders when it guarantees the loan, unrestricted secondary market trading in such guarantees that might result in purchase by a public lender should not be objectionable.

EDA further argues that the legislative basis for the establishment of the private borrower-private lender requirement provides another reason for distinguishing between the current proposal and the Chicago plan. EDA maintains that the intended purpose of this statutory requirement was to prevent EDA from participating in the guarantee of tax-exempt bonds which can ordinarily only be issued by some type of public borrower. See H. Rep. No. 89-539, 89th Cong. 1st Sess. (1965). Since the use of tax-exempt bonds to finance Chicago's participation was a crucial aspect of the earlier proposal, EDA now states that implementation of that proposal would have been in "direct contravention" of the intent of Congress in imposing the private borrower-private lender requirement. However, EDA contends that the present proposal would not necessarily involve EDA's participation with tax exempt obligations since such participation, if not predicated at the time the underlying loan and guarantee transaction is established, "is highly unlikely to occur as part of normal secondary market trading."

With respect to EDA's primary argument, we do not believe that the legality of this type of arrangement should hinge on whether or not the public lender's participation in the program as a secondary market purchaser of the guaranteed note is contemplated from the inception of a loan or merely occurs in the normal course of secondary market operations. As recognized by EDA in its submission, the purchaser of a guaranteed note in the secondary market becomes in effect "the lender of the guaranteed loan." Therefore, whether or not the sale of a guaranteed note to the public lender is necessarily contemplated from the beginning of a transaction, once the public lender purchases the guaranteed note the end result is the same, i.e., the public lender becomes the source of the funds covered by EDA's guarantee. While our decision of September 6, 1979, does refer to the fact that the then proposed program necessarily contemplated from its inception the involvement of a nonprivate lender, the primary basis for our refusal to approve the proposal was our view that the arrangement would allow "EDA indirectly to do something that it could not do directly—guarantee a loan by a non-private lender". We believe that the same deficiency exists with respect to EDA's current proposal.

Concerning EDA's argument that the two proposals are distinguishable because the current plan, unlike the earlier one, would not contravene the intent of Congress in imposing the private borrower-private lender requirement that guarantees of loans financed with tax-exempt bond issues should be precluded, neither the statutory language nor its legislative history indicates that loans by public lenders could be guaranteed by EDA as long as they were not tax-exempt. Moreover, when we requested EDA to provide us with its comments in connection with our consideration of the Chicago proposal, EDA stated with respect to the tax-exempt issue that it "does not consider the nature of the bond issuance to be a material consideration." Accordingly, our decision was not based on, nor did we consider, the possibility that the bonds sold by the City would be tax-exempt. In our view then, as now, the legality of this type of arrangement does not turn on whether or not tax-exempt obligations are involved. Also, we note that EDA was not able to assure us, assuming we approved the current proposal, that it would never be in a position of guaranteeing tax-exempt obligations.

Finally, we believe that this proposal would be extremely difficult if not impossible for EDA to implement. If we approved this proposal, without reversing our opinion regarding the Chicago plan, EDA would be in a position of having to determine whenever a guaranteed note was to be sold, or perhaps even before the initial guarantee was approved, whether or not it was contemplated at the inception of the loan that a public lender would purchase the guaranteed note. Thus, the question of whether a particular transaction involving the sale of a guaranteed note was legal or illegal would necessarily depend not on an objective determination—was the purchaser a "private lending institution" as that term is used in the statute—but on the subjective determination as to the intent of the parties when they entered into and implemented the transaction. In our view, this would impose an administrative burden on EDA that would be virtually impossible for it to fulfill.

In accordance with the foregoing it is our view that public lenders are not eligible to participate as secondary market purchasers of EDA guaranteed loans under any circumstances.

Milton J. Socolar

for Comptroller General
of the United States