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DECISION

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

[Recovery of Interest Earned on CSA Grant Funds]

FILE: B-192459

DATE: July 1, 1980

MATTER OF: Community Services Administration - ^{ACC} 177
Interest on Grant Funds

DIGEST: Interest earned by trustee holding CSA grant funds as part of complex construction arrangements does not create Government right to interest since transfer of grant funds by Hahnemann Hospital to trustee under facts presented amounted to application of funds to grant purposes.

Interest earned on advance of grant funds to grantee hospital prior to transfer of funds to trustee must be paid over to Government since retention of interest prior to grant application is not authorized by law.

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The Director of the Community Services Administration (CSA) has requested our decision concerning whether it must recover interest earned by Hahnemann Hospital of Philadelphia (Hahnemann) on certain CSA grant funds awarded the hospital in 1975 to assist in the construction of a new hospital facility. As discussed in greater detail below, we have concluded that the interest earned by Hahnemann on grant funds prior to the application of these funds to grant purposes must be recovered, but that interest earned after the grant funds were expended and applied to grant purposes is to be retained in the grant program under the terms of the grant agreement.

CSA has provided us with the following facts:

"On September 29, 1975, CSA made a \$14.5 million grant to Hahnemann Hospital to complete construction of a new medical facility. The grant was made from the Agency's 1975 supplemental appropriation pursuant to a specific Congressional

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directive contained in the reports of both the House and Senate Committees on appropriations (Senate Report 94-137, House Report 94-141. * * *). In the language of both these reports, Congress indicated its intent that the funding be provided under the economic development authority of Title VII of the Economic Opportunity Act of 1964, as amended. (the Act) The reports noted that the grant would enable Hahnemann to provide '. . .social service support and complementary community economic development through provision of health services, child care services and educational services; . . .' (Id. p. 35).

"Because Hahnemann was unable to meet certain Title VII requirements, the grant was not made as an economic development grant under Title VII of the Act, but as a special assistance grant under Section 234 of Title II of the Act. The funds were transferred from Title VII to Title II pursuant to the Director's transfer authority in Section 616 of the Act.

* * * * *

"The grant funds provided by CSA under its 1975 grant were released to Hahnemann Hospital in two major installments. The first installment, \$2,582,286 was released on November 19, 1975. The correspondence requesting the initial release indicated that the funds would be invested in certificates of deposit and in a savings account, all of which would earn interest. Neither the account nor the certificates of deposit were subject to any trust or escrow requirements, or specifically obligated in any other manner.

"From the time of release to the establishment of the Trust Indenture in August of 1976, only \$472,000 of the \$2,582,286 was expended by

Hahnemann. The remainder, plus \$86,567 in earned interest was transferred on August 5, 1976 to the Girard Trust Bank for deposit into the 'Federal Construction Account' of the hospital construction fund. This fund was controlled by Girard Bank as Trustee, pursuant to a Trust Indenture entered into between Hahnemann and the Hospital authority. Interim feasibility reports and the final report prepared by the feasibility consultant for the bond sale reflected projections of income earned on the first release CSA funds. Thus, while these funds were not expended or obligated, at least until transfer to the Girard Bank, the availability of the funds and income earned thereon for construction costs was clearly contemplated and relied on by all parties, including CSA.

"The second installment on the CSA grant, \$11,917,714, was released by CSA on July 30, 1976; and the United States Treasury check for that amount was immediately negotiated by Hahnemann to the Girard Trust Bank for deposit in the Federal Grant Account of the construction fund.

"Girard Trust Bank was Trustee for the construction fund pursuant to a Trust Indenture between Hahnemann Hospital and the Hospital Authority of Philadelphia. This Indenture was entered into August 1, 1976. Section 5.01 of the Indenture stated:

'...the Trustee shall maintain any construction fund into which any governmental grant has been deposited in accordance with any applicable regulations or standards required under the terms of such grant...'

'The Trustee shall establish within the construction fund a Federal Grant Account into which there shall be deposited the

sum of \$14,114,167.18, contributed by Hahnemann as the balance of funds under its Grant Agreement 30198 with Community Services Administration and to which account there shall be credited investment earnings on the monies therein.'

* * * * *

"The grant from CSA to Hahnemann specifically authorized Hahnemann, by special condition, to retain all interest earned on the unexpended grant funds.* * *
Allowing grantees to retain interest earned on unexpended grant funds awarded and released for economic development projects was agency policy in 1975, regarded as legal and appropriate by the agency's then General Counsel. CSA's present General Counsel has advised that the agency's interest retention policies, particularly with regard to Title II grants such as the Hahnemann grant, are now, and were in 1975, improper and contrary to administrative law as expressed in the policies of Department of Treasury Circular 1075 rulings of the Office of the Comptroller General.* * *
The present General Counsel ruling gives rise to the issue whether CSA is to seek the return of the interest earned by Hahnemann which to date amounts to more than \$1.8 million dollars."

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Under the facts presented, interest was earned under two different sets of circumstances; first, interest was earned by Hahnemann prior to transfer of grant funds to Girard Trust Bank, and second, interest was earned and continues to be earned under the Federal grant account maintained by Girard Trust Bank.

Accordingly, CSA poses two specific questions:

- (1) "Is CSA to abide by the express term of the grant/contract between CSA and Hahnemann which awarded Hahnemann all

interest earned on unexpended grant funds, or is CSA to seek recovery of all interest earned by Hahnemann on unexpected [sic] CSA awarded funds?"

- (2) "May CSA consider the grant funds as obligated or expended at the time they were deposited in the Federal Grant Account of the construction fund, thus permitting the grantee Hahnemann Hospital to retain all interest earned on the funds while on deposit in the Federal Grant Account on the Construction Fund."

As recognized by CSA, the longstanding rule is that interest earned by a grantee on funds advanced by the United States belongs to the United States rather than the grantee and must be returned, except as otherwise provided by law. B-196794, January 17, 1980, 59 Comp. Gen. ___ (1980); 42 Comp. Gen. 289 (1962) and cases cited therein. However, once grant funds are applied to the accomplishment of the purpose of the grant, the rule does not apply. The rule was explained in 1 Comp. Gen. 652 (1922), a case involving an early grant program to the States:

"There is no specific requirement of law that funds paid to the States shall draw interest or that any interest accruing on deposits of such funds shall be accounted for to the United States, but the act does not contemplate that the States shall profit by the statute otherwise than in the manner and to the extent specifically provided for by law. While the law provides for payment of the allotments to the States upon certificate of compliance with the statutory requirements, the moneys so paid by the Federal Government are held in trust by the States for the purposes of the act until they have been expended for those purposes. The law does not contemplate that the moneys shall be held by the States and bear interest, but shall be promptly applied to the purpose for which

furnished, and the moneys should not be furnished in amounts necessarily resulting in large sums being held, and thus bear interest, but where in the ordinary procedure of moneys being placed in a depository interest is obtained any interest accruing while the moneys are so held by the States inures to the benefit of the United States as owner of the funds and not to the States as trustees and should be accounted for and paid into the United States Treasury accordingly." Id. at 655.

(States, under 42 U.S.C. 4213 (1976), are no longer required to account for, and can retain interest if earned on advances of grant funds.) Accordingly, in reaching a decision on what should happen to interest earned on the Hahnemann grant fund, it is necessary to determine how the interest in question fits the general rule. Because of our answers, we will dispose of the interest earned by Girard Trust Bank as trustee first.

Interest Earned by Trustee.

The largest amount of interest (over \$1.7 million as of July 1978) accruing under the grant has accrued to the Girard Trust Bank in its Federal Grant account which it holds as trustee in the complex hospital construction financing arrangement. CSA has summarized the arrangement under which the Girard Trust Bank holds the grant funds as follows:

"In order to remodel its existing hospital facility and construct a new medical tower, Hahnemann estimated approximately \$65 million would be necessary. This amount was to be derived from approximately \$7.3 million of capital contribution by Hahnemann, the \$14.5 million from the CSA grant, the \$39.6 million from the sale of bonds by the Philadelphia Hospital Authority and the interest earned on the funds once invested. The entire financing package is described in the attached prospectus issued in connection with the bond sale. The bonds were issued by the Hospital Authority and sold to underwriters led by Kidder Peabody & Co. for resale to the public.

"The proceeds of the bond sale were paid by the Hospital Authority as a lump sum rental to the trustee on assignment by Hahnemann for lease (lease contract) of certain real and personal property including the land on which the medical tower was to be built. The hospital also deposited the proceeds from CSA's grant with the trustee for construction of the hospital. Thus, the trustee (Girard [sic] Trust Bank) accepted pursuant to the trust indenture the hospital's capital construction, the CSA grant funds and the proceeds from the bond sale to pay all remodeling and construction costs.

"To repay the capital and interest to the bondholders, the Hospital Authority retained a thirty-three year lease on the hospital's medical tower and other personal and real property which it then subleased back to Hahnemann to operate. The proceeds of this sublease contract were to be used by the authority to pay the yearly principal and interest charges until the debt is liquidated in 2009.

"In the trust indenture, the Hospital Authority pledged all receipts derived from its sublease to Hahnemann of the medical tower and other property to repay the bonded indebtedness. In addition to the trust arrangements for repayment of the bonds, Hahnemann separately in the Guaranty Agreement with the trustee unconditionally guaranteed payment of the principal and interest on the bonds as they become due.

"Thus, trustee's function is twofold. First, it guaranteed that all contributed capital along with the interest earned thereon would remain available for payment of the cost of remodeling the old hospital and of constructing the new medical towers* * *. Second, it received the sublease payments from the Hospital Authority to pay certain administrative expenses and liquidate the bonded indebtedness* * *."

Based on the principles discussed above, the issue here is whether the transfer of the grant funds to Girard Trust Bank was a disbursement or expenditure (i.e., an application of those funds) for grant purposes. If not the interest earned on the grant funds must be returned to the Government; if so, the interest can be retained.

The transfer of grant funds to the Girard Trust Bank has the following characteristics of a disbursement or expenditure: (1) Hahnemann did not retain possession of the grant funds, (2) Hahnemann could not get the funds back upon demand, (3) the Girard Trust Bank is an independent stakeholder for the parties in the construction arrangement and not the agent of Hahnemann, and (4) Hahnemann received something in exchange for the transfer of funds -- the promise of a new hospital structure together with sufficient funds to allow for completion of its construction.

We conclude that, taken as a whole, the construction financing arrangement described above was an expenditure or disbursement for grant purposes and accordingly the interest earned under the grant account is grant income subject to the grant agreement. See OMB Circular A-110, Attachment D, paragraph 5. We note that while we have answered the second CSA question in the affirmative, we have done so on the basis that Hahnemann does not itself control the interest earned on the grant funds as suggested in the way CSA's question is phrased.

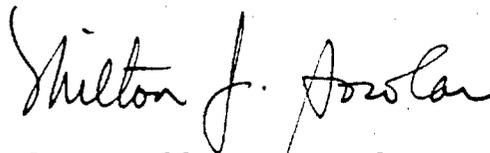
Interest Earned by Hahnemann.

We are now left with CSA's first specific question as it applies to interest earned prior to transfer to the Girard Trust Bank. By contrast to interest earned after the transfer, the \$86,567 of interest earned by Hahnemann in bank accounts and certificates of deposit is clearly interest of the kind that must be returned to the Government under the general rule on interest earned on advances of grant funds. According to CSA, the first installment of the grant withdrawn by Hahnemann in November 1975 was placed in a savings account and certificates of deposit before they were applied to grant purposes. Allowing Hahnemann to obtain funds prior to a need for them in carrying out the grant purposes is also contrary to Treasury Circular 1075 which provides in section 205.4(a):

"(a) Cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs."

We conclude that under these circumstances and absent any express exception to the general rule that would permit grantees to retain interest, CSA lacked authority to approve the retention by the grantee of interest earned on grant funds prior to their application to grant purposes.

When CSA originally submitted this matter for our determination, it did not distinguish between the interest earned by Hahnemann prior to application of the funds to grant purposes and the interest earned by the Girard Trust Bank. Accordingly, in support of the retention of at least some of the interest, CSA advanced a variety of multiple and complex arguments, such as that the grant term was constitutionally protected against contract impairment. In view of our holding in this case and our understanding of CSA's current position, we do not feel it is necessary to address these issues. However, if CSA, in light of our decision, wants this Office to consider any or all of these arguments with respect to the interest earned by Hahnemann, it should resubmit them with specific reference to the circumstances surrounding this lesser amount.



Acting Comptroller General
of the United States