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The Honorable John McCain
Ranking Minority Member
Committee on Commerce, Science and Transportation
United States Senate

Subject: Use of Proceeds from the Sale of Real Property Purchased with Federal Highway Funds

Dear Senator McCain:

This is in response to your letter dated April 3, 2002, requesting our views regarding the Federal Highway Administration's (FHWA) interpretation of 23 U.S.C. § 156 (2000). As explained below, § 156 authorizes states to use the proceeds from sales of real property purchased with federal funds for other eligible projects. Your letter asks whether the proceeds from real property sales retain their character as federal funds under § 156; you also ask questions about how the states have applied § 156. This opinion addresses the proper interpretation of § 156. The remaining issues you raise will be addressed in a separate GAO report.

Under § 156, and in particular, § 156(c), states disposing of excess property acquired with Federal Highway Trust (title 23) funds are authorized to reapply the federal share of the proceeds to other eligible title 23 projects. The FHWA construes § 156 as allowing states to treat the proceeds of excess property sales as state funds. FHWA believes that the federal government retains no residual interest in those proceeds. It has informed the states that projects funded through proceeds from such transactions are not subject to restrictions that would otherwise apply if such funds were treated as federal funds.

As your letter points out, the Department of Transportation's (DOT's) Office of Inspector General (DOT-IG) questioned FHWA's interpretation of §156 in its report, *October 2001 Finance Plan for the Central Artery/Tunnel Project,* IN-2002-086, March 11, 2002. You ask us to examine the issues raised in the DOT-IG's report and determine whether FHWA's interpretation is correct. In this regard, you would also like us to consider whether states (1) can convert federal money to state money by buying and selling property, (2) can use such means to reduce or avoid their obligation to provide matching funds, and (3) can thus avoid normal safeguards on the use of federal funds.

As explained below, we disagree with FHWA's interpretation of § 156. Section 156 permits states to apply the federal share of proceeds of excess property dispositions to other title 23 projects *in lieu* of returning those funds to the Highway Trust Fund. The federal interest in such funds is not extinguished. Consequently, states may not convert federal money to state money by buying and selling property or use the federal share of recaptured funds to reduce or avoid their obligation to provide matching funds.

Background

Prior to 1998, if a state sold real property purchased with federal highway funds, it had to return the federal share of the net proceeds of the sale to FHWA. In 1998, Congress adopted the Transportation Equity Act for the 21st Century (TEA-21), Pub. L. No. 105-178, title I, § 1303(a), 112 Stat. 227 (1998), which authorized states to reapply the federal share to other projects. As amended by TEA-21, 23 U.S.C. § 156 reads as follows:

"(a) Minimum charge.–… a State shall charge, at a minimum, fair market value for the sale, use, lease, or lease renewal (other than for utility use and occupancy or for a transportation project eligible for assistance under this title) of real property acquired with Federal assistance made available from the Highway Trust Fund….

(b) Exceptions.–The Secretary may grant an exception to the requirement of subsection (a) for a social, environmental, or economic purpose.

"(c) Use of Federal share of income.–The Federal share of net income from the revenues obtained by a State under subsection (a) shall be used by the State for projects eligible under this title."

The predecessor to § 156 of title 23, U.S.C., applied only to the sale, use, lease or lease renewals of "right-of-way airspace," as opposed to the broader coverage of "real property" under TEA-21. It provided:

"… States shall charge, as a minimum, fair market value, with exceptions granted at the discretion of the Secretary for social, environmental, and economic mitigation purposes, for the sale, use, lease, or lease renewals (other than for utility use and occupancy or for transportation projects eligible for assistance under this title) *of right-of-way airspace* acquired as a result of a project funded in whole or in part with Federal assistance made available from the Highway Trust Fund…. The Federal share of net income from the revenues obtained by the State for sales, uses, or leases (including lease renewals) under this section shall be used by the State for projects eligible under this title." (Emphasis added.)

FHWA correctly interprets the TEA-21 amendment as expanding the scope of § 156 to allow reapplication of the proceeds from all real property dispositions, including the disposition of excess real property. It goes on, however, to apply its interpretation of air rights dispositions under the pre-TEA-21 statute to excess property dispositions. Under the prior statute, FHWA treated air rights receipts as being in the nature of project income that it believes the states had the right to use as they saw fit. Indeed, until the current regulations were adopted in 1999, FHWA's regulations stated that "Disposition of income received from the authorized use of airspace shall be the [state highway department's] responsibility and credit to Federal funds is not required."[1] Starting from this vantage point, FHWA now reads the current language of § 156 as extinguishing the federal share in all proceeds from the disposition of any kind of real property, allowing the states to treat all proceeds as state funds. It reads its regulation, 23 C.F.R. § 710.403(e), added by 64 Fed. Reg. 71290 (Dec. 21, 1999), similarly. That regulation provides

> "The Federal share of net income from the sale or lease of excess real property shall be used by the STD for activities eligible for funding under title 23 of the United States Code. Where project income derived from the sale or lease of excess property is used for subsequent title 23 projects, use of the income does not create a Federal-aid project."

As noted, FHWA's views regarding the proceeds from the sale of excess property were questioned by the DOT-IG in its recent report concerning the October 2001 finance plan for the Boston Central Artery/Tunnel Project (CA/T Project). The CA/T Project was unique in that Congress capped the total amount of federal funds for the project at $ 8.549 billion. Department of Transportation and Related Agencies Appropriations Act, Pub. L. No. 106-346, § 340(d), 114 Stat 1356 (2000). The DOT-IG found that this amount was fully identified in the CA/T Project Finance Plan but that Massachusetts intended to sell land on which it had temporarily located its project headquarters, reinvesting that money in the project as "state funds." Pointing out that the federal government had contributed a significant portion of the monies the state would realize, the DOT-IG questioned reclassification of that money as state funds and concluded that the CA/T cap would be exceeded if that money was counted as part of the federal share.

In rejecting FHWA's position that a sale or other disposition of excess property extinguishes the federal share, the DOT-IG stated that in its opinion the better view is that in TEA-21 Congress intended merely to streamline the process for reapplying the federal share of real estate proceeds to other federal-aid projects but did not intend to extinguish the federal share of the money. In support of this view, the DOT-IG observed that § 156(c) specifically refers to the "federal share" of the net income from the proceeds obtained by a state from the sale or lease of excess property. The DOT-IG also pointed out that consequences of FHWA's position might include allowing states: (1) to convert federal to state money by buying and selling property, (2) to use such transactions to reduce or avoid their obligation to make matching contributions, and (3) to avoid the safeguards that govern the expenditure of federal funds. The DOT-IG stated that the better view of the statute was that the federal share of real property remains federal money but that the states should be permitted to reapply the money to other eligible projects.

In reviewing the DOT-IG report, we focused on the general issue of how the proceeds from excess property sales should be treated under § 156. We did not review matters

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[1] 23 C.F.R. § 713.204(v), adopted, 39 Fed. Reg. 34651 (Sept. 27, 1974), repealed by adoption of 23 C.F.R. § 710.403(e) in 1999. *See* 64 Fed. Reg. 71284 (Dec. 21, 1999).

that were not raised by your request (*e.g.,* the nature of the credit for recaptured property and the CA/T cap).

FHWA's Comments

As did the DOT-IG, we requested that FHWA provide us with a written explanation of its interpretation. According to FHWA, the TEA-21 amendment of § 156 was proposed by the executive branch in order to combine the rules governing disposal of excess real property by sale or lease with the rules governing the disposition of air rights. FHWA says this was done to reduce administrative overhead by eliminating different sets of rules and by simplifying those rules. It points out that in drafting TEA-21 the Senate Committee on Environment and Public Works embraced its rationale, stating that the purpose of the change was to simplify property management practices by applying the same standard to all real property interests acquired with Federal-aid highway funds. S. Rep. No. 105-95, at 28-39 (1997). The Senate provision was adopted in the Conference Report, H.R. Conf. Rep. No. 105-550, at 424-425 (1998).

In addressing this matter in its comments to the DOT-IG and our office, FHWA maintains that nothing in § 156 either after amendment by TEA-21 or before, or the legislative history of either provision, could be construed to require that § 156 proceeds be treated as federal funds or be returned to the Treasury, to the Highway Trust Fund, or to the apportionment category from which they were derived. In its analysis, FHWA acknowledged the government-wide common rule[2] governing grants to states and local governments, under which the federal government retains a percentage interest in the proceeds from real property sales. However, with little explanation, it dismissed this retained federal interest as "superceded by" § 156, as amended, and by its regulation.

In its submission to our office, FHWA asserts that the income resulting from real property sales should be treated in the same manner as were air rights receipts, namely as project income that the states should have the right to use as they see fit. To support its view that the disposition of income received from the authorized use of airspace should be left to the state highway department and that no credit to federal funds was required, it cites our decision at 41 Comp. Gen. 653 (1962) in which we addressed the way states handle airspace-use revenue.

Analysis

We agree with the DOT-IG's view that Congress, by adding the disposition of excess property to the authority granted by § 156, intended merely to streamline the process for reapplying the federal share of real estate proceeds to other federal-aid projects.

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[2] *See Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments,* 49 C.F.R. pt. 18, adopted originally at 53 Fed. Reg. 8034, 8086 8087 (March 11, 1988), the objective of which was to create insofar as possible a single, common set of requirements for administering federal government grants and cooperative agreements with state and local government.

The statute says nothing about the federal share losing its identity. To the contrary, § 156 refers to a "federal share" in the proceeds of a real property disposition. The statute states simply that any *federal share in the net proceeds*,[3] which a state receives as a result of the sale, use, lease or lease renewal of such property, is to be applied to other eligible title 23 projects. Logically, the use of the term "federal share" indicates that the federal share retains its character as federal funds. Furthermore, by providing in § 156(a) that states must dispose of real property at fair market value, unless the *Secretary* grants an exception for a social, environmental, or economic purpose, the statutory text evidences a strong and on-going federal interest in any revenues generated from such disposal.[4] In our view, this is a clear indication that the federal share of these proceeds should continue to be treated as federal rather than state funds.

Congress's continuing interest in the federal share of air rights and recaptured excess property sales proceeds is illuminated by examining the historical background leading to enactment of § 156. As FHWA notes, that history begins with our 1962 decision, 41 Comp. Gen. 653. There the Bureau of Public Roads had proposed to recapture the federal share of funds in air rights disposals by requiring that the federal share be applied (1) to other interstate system projects or (2) to finance other (non-Federal-aid) highway projects. 41 Comp. Gen. at 655. Our decision pointed out that Congress had not considered that issue and hence provided no specific direction concerning the disposition of receipts from the use of air space. 41 Comp. Gen. at 657. Accordingly, absent statutory language authorizing the Bureau to require that the proceeds derived from air rights be used as proposed, we found that the state was free to retain the proceeds. That said, we recognized the significance of the federal contribution in Federal-aid projects and suggested that the Assistant Secretary recommend that Congress consider an amendment providing an appropriate credit to the United States from any profits derived by a state from the use of air rights. 41 Comp. Gen. at 657-658.[5]

Subsequently, Congress adopted the language that is now § 156(c) in the Surface Transportation and Uniform Relocation Assistance Act of 1987, Pub.L. 100-17, title I, § 126(a), 101 Stat. 167 (1987). The original text of § 156 dealt only with the disposal of

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[3] The term "net income" is not defined in the act. It could be interpreted as referring to a federal share in the profits of a sale, but it appears more likely in context and in view of the usage of "net proceeds" in the common rule that the intent was to address the use of proceeds remaining after the costs associated with the real property disposition were deducted.

[4] The importance of this is emphasized by the Conference Report on TEA-21, which indicates that the House agreed to the changes to § 156 as adopted by the Senate after the Senate agreed to include an exception to allow the states *with the Secretary's approval* to dispose of property in some instances at less than fair market value. H. Rep. No. 105-550, at 424-425 (1998).

[5] FHWA told us that to comport with our opinion it adopted its 1974 regulation stating that state highway departments could dispose of airspace income without making any credit to federal funds. See footnote 1 for citations.

air rights and tracks the Bureau's 1962 proposals discussed in 41 Comp. Gen. at 655. In other words, in 1987, Congress asserted an interest in the federal share of the proceeds resulting from the disposition of air rights. The fact that § 156 allows states to use the federal share of net income from such proceeds for title 23 projects does not detract from, and indeed is entirely consistent with, the proposition that Congress had addressed what it perceived as the federal interest in such proceeds.

Under the common grant rules, air right proceeds, unlike proceeds from the sale of excess property, were (and are still) treated as program income. Such proceeds are to be handled as a deduction, reducing total allowable project costs (federal and state share) by the total amount. 49 C.F.R. § 18.25(g)(1). The DOT implementation of the common rule, adopted just after enactment of the 1987 act, expressly refers to § 156, stating that the statute requires that all such proceeds be applied to title 23 eligible projects. 49 C.F.R. § 18.25(g)(7). Thus, the common rule as applied to air rights also recognizes a substantial federal interest in those proceeds.

The common rule governing the sale of excess property clearly articulates the federal government's interest, as well, in controlling the proceeds of sale. The regulations at 49 C.F.R. § 18.31 then provided (and still provide) that a grantee state, upon determining that real property is no longer needed for the originally authorized purpose, must request disposition instructions from the awarding (grantor) agency, which may include retention or transfer of title, or sale of the property. 49 C.F.R. § 18.31(c). The grantor agency is compensated if the property is retained for use for other purposes, or sold. *Id.* The amount due the awarding agency is calculated by applying the awarding agency's percentage of participation in the cost of the original purchase to the fair market value or proceeds of the sale after deducting actual and reasonable associated expenses. 49 C.F.R. § 18.31(c)(2). Thus, under the common rule, a state would be required to return to FHWA the federal share of the net proceeds resulting from the disposal of real property acquired with federal grant funds.

It is in this light that we consider FHWA's argument that the absence of specific language in the statute or its legislative history indicating that any part of the proceeds be returned to FHWA or credited to federal funds supports its construction of the statute. In our view, FHWA has the argument precisely backwards. As applied to the sale of excess property, the common rule protected the federal government's interest in its share of the proceeds. Absent specific legislative direction to the contrary, the natural presumption is that by enacting § 156 Congress meant only to authorize states to apply the recaptured federal share to other eligible projects, rather than return such amounts to FHWA. There is nothing in this legislative action that is inconsistent with the proceeds retaining their character as federal funds.

The common rule, of which Congress was presumably aware when it adopted TEA-21, has not been amended in response to the adoption of TEA-21. This is appropriate, we believe, because properly understood the common rule and § 156 are entirely consistent when read together. In § 156, Congress said nothing explicitly or implicitly that would alter the federal character of these funds, which is so clearly articulated in the common rule. TEA-21 sought to enhance administrative effectiveness by allowing recovered funds to be transferred for use in other title 23 projects but reflects Congress's continuing interest in grant funds provided by the federal government. Viewed from this perspective, it is not reasonable to interpret the § 156(c) language as indicative of any intent by Congress to negate the federal character of proceeds captured upon the sale of excess property.

We recognize that the DOT-IG's report, after questioning FHWA's interpretation of § 156, states that in view of FHWA's administrative role it will defer to FHWA's interpretation provided DOT's Office of General Counsel would formally concur with FHWA's position. The DOT-IG also required that the appropriate congressional committees be notified of that concurrence.

As a general proposition, an agency's interpretation of a statute it is charged with administrating is entitled to deference. *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.,* 467 U.S. 837, 842-843 (1984); *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Skidmore v. Swift & Co.,* 323 U.S. 134 (1944). This discretion, however, is not without limits. The agency's interpretation must be reasonable and must be based on a permissible construction of the statute. See, e.g., *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.,* 467 U.S. at 844. For the reasons discussed we do not view FHWA's position as a reasonable construction of the statute.

Based on the above, we do not agree with FHWA's interpretation of § 156. Buying and selling real property does not extinguish the federal character of these funds. Consequently, we do not believe states can convert federal money to state money by buying and selling property or use the proceeds of such transactions to reduce or avoid their matching fund obligations or to avoid normal safeguards on the use of federal funds.

Sincerely yours,

Anthony H Gamboa

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