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# MASS TRANSPORTATION THROUGH CREATIVE FINANCING: THE PORT AUTHORITY BUS PROGRAMS\*

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## *Introduction*

On March 1, 1979, Governor Brendan T. Byrne of New Jersey and Governor Hugh L. Carey of New York met at the Port Authority Bus Terminal, and, in a brief ceremony, signed into law concurrent bi-state legislation enabling The Port Authority of New York and New Jersey (Port Authority) to fulfill a long-standing commitment to assist the mass transportation capital programs of both States.<sup>1</sup> Based upon a recognition of need, the Legislature of each State authorized the Port Authority to participate in a program which would provide buses and ancillary bus facilities to the two States.<sup>2</sup> This article will analyze the impact of the Port Authority Bus Programs on New Jersey's mass transportation capital program, and how the creative use of federal funding under the Urban Mass Transportation Act of 1964<sup>3</sup> and the safe-harbor leasing provisions of the Economic Recovery Tax Act of 1981<sup>4</sup> enabled New Jersey to effectively develop and improve its mass transportation capital infrastructure.

## *Background of the Port Authority*

The Port Authority, a municipal corporate instrumentality of the States of New York and New Jersey, was created in 1921 by compact between the two States<sup>5</sup> with the consent of the Congress of the United

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\* The views expressed in this article are entirely those of the authors and are in no way intended to reflect the policies of The Port Authority of New York and New Jersey or of the States of New Jersey or New York or their respective agencies.

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<sup>1</sup> N.J. STAT. ANN. §§ 32:2-23.27 to -23.42 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS §§ 7201-7217 (McKinney Supp. 1983-84).

<sup>2</sup> N.J. STAT. ANN. § 32:2-23.29 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7203 (McKinney Supp. 1983-84).

<sup>3</sup> 49 U.S.C.A. §§ 1601-1618 (West 1976 & Supp. 1983).

<sup>4</sup> Pub. L. No. 97-34, 95 Stat. 172 (1981).

<sup>5</sup> N.J. STAT. ANN. § 32:1-1 (West 1963); N.Y. UNCONSOL. LAWS § 6401 (McKinney 1979).

States.<sup>6</sup> In that compact the two States recited their belief that "better co-ordination of the terminal, transportation and other facilities of commerce in, about and through the [P]ort of New York [would] result in great economies, benefiting the nation, as well as [themselves]. . . ."<sup>7</sup> Both States recognized that the future development of such facilities would require their "cordial co-operation . . . in the encouragement of the investment of capital, and in the formulation and execution of the necessary physical plans."<sup>8</sup> It was determined that this result could best be accomplished "through the co-operation of the two [S]tates by and through a joint or common agency,"<sup>9</sup> and to that end The Port of New York Authority was created.<sup>10</sup>

The Port Authority consists of a twelve-member Board of Commissioners,<sup>11</sup> and is generally empowered to provide transportation, terminal, and other facilities of commerce within the Port of New York District.<sup>12</sup> To accomplish this purpose, the Port Authority is authorized to borrow monies through the issuance of bonds and other obligations. The Port Authority, however, has no power to levy taxes or assessments; its bonds or other obligations are not obligations of the two states or either of them, and, with the exception of the New York State Guaranteed Commuter

<sup>6</sup> H.R. Res. 337, 76th Cong., 2d Sess., 42 Stat. 822 (1922); S.J. Res. 88, 67th Cong., 1st Sess., 42 Stat. 174 (1921).

<sup>7</sup> N.J. STAT. ANN. § 32:1-1 (West 1963); N.Y. UNCONSOL. LAWS § 6401 (McKinney 1979).

<sup>8</sup> N.J. STAT. ANN. § 32:1-1 (West 1963); N.Y. UNCONSOL. LAWS § 6401 (McKinney 1979).

<sup>9</sup> N.J. STAT. ANN. § 32:1-1 (West 1963); N.Y. UNCONSOL. LAWS § 6401 (McKinney 1979).

<sup>10</sup> N.J. STAT. ANN. § 32:1-4 (West 1963 & Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6404 (McKinney 1979). The name of the Port Authority was changed in 1972 from "The Port of New York Authority" to "The Port Authority of New York and New Jersey."

<sup>11</sup> N.J. STAT. ANN. §§ 32:1-5, 32:2-2 to -5 (West 1963); N.Y. UNCONSOL. LAWS § 6405 (McKinney 1979); Act of April 12, 1930, ch. 422, 1930 N.Y. Laws 896. The Board of Commissioners is comprised of six resident voters from each of the two States. The commissioners are appointed to six-year terms by the Governor of each State with the advice and consent of the Senate.

<sup>12</sup> The Port District is described by metes and bounds in N.J. STAT. ANN. § 32:1-3 (West 1963); N.Y. UNCONSOL. LAWS § 6403 (McKinney 1979). The Port District includes the Cities of New York and Yonkers in New York State and the Cities of Newark, Jersey City and Elizabeth in New Jersey. The Port Authority owns and/or operates various facilities of transportation and commerce in each of the two states including, in addition to the Port Authority Bus Programs, the Holland and Lincoln Tunnels; the George Washington, Bayonne, and Goethals Bridges; Outerbridge Crossing; the Port Authority Bus Terminal; the Hudson Tubes; the New York Union Motor Truck Terminal; LaGuardia, John F. Kennedy, Newark, and Teterboro Airports; the Port Authority-West 30th Street and Downtown Manhattan Heliports; the Oak Point Rail Freight Link; Port Newark; the Hoboken, Brooklyn, Erie Basin, Elizabeth and Columbia Street Port Authority Marine Terminals; the New York City Passenger Ship Terminal; the World Trade Center; Bathgate Industrial Park; and the Teleport, a satellite communications center in Staten Island, New York.

Car Bonds,<sup>13</sup> are not guaranteed by the states or either of them. The Port Authority is also empowered to establish charges for the use of its facilities,<sup>14</sup> and, in connection with specific facilities, may acquire real and personal property by condemnation, eminent domain, or otherwise.<sup>15</sup>

The Port Authority's bridge and tunnel tolls increase in 1975 was expected to make possible the provision of \$400 million for additional mass transportation capital facilities.<sup>16</sup> Of this sum, \$160 million was to be allocated to the extension and modernization of the Port Authority Bus Terminal.<sup>17</sup> It was contemplated that the remaining amounts would be allocated to a number of projects authorized by the Legislatures of the two States, including rail access to Newark International Airport from the City of Newark,<sup>18</sup> rail access to John F. Kennedy International Airport from Queens County,<sup>19</sup> improved highway access to the air and marine terminals operated by the Port Authority,<sup>20</sup> as well as improved railroad freight access to those terminals.<sup>21</sup> Additionally, an extension of the Port Authority Trans-Hudson system to Plainfield, New Jersey was planned.<sup>22</sup>

The United States Supreme Court's holding in *United States Trust Company of New York v. New Jersey*,<sup>23</sup> however, effectively precluded Port Authority involvement in additional deficit passenger rail facilities other than the Port Authority Trans-Hudson system. The circumstances giving rise to that case began in 1962. In that year, the States of New York and New Jersey covenanted with each other and with affected bondholders

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<sup>13</sup> N.J. STAT. ANN. §§ 32:2-23.20 to -23.26 (West 1963); N.Y. UNCONSOL. LAWS §§ 6771-6778 (McKinney 1979).

<sup>14</sup> N.J. STAT. ANN. § 32:1-7 (West 1963); N.Y. UNCONSOL. LAWS § 6407 (McKinney 1979).

<sup>15</sup> See, e.g., N.J. STAT. ANN. § 32:1-35.22 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6653 (McKinney 1979); N.J. STAT. ANN. § 32:1-35.9 (West 1963); N.Y. UNCONSOL. LAWS § 6639 (McKinney 1979); N.J. STAT. ANN. § 32:1-35.33 (West 1963); N.Y. UNCONSOL. LAWS § 6676 (McKinney 1979).

<sup>16</sup> N.J. STAT. ANN. § 32:2-23.27(i) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7201(9) (McKinney Supp. 1983-84).

<sup>17</sup> N.J. STAT. ANN. § 32:2-23.27(i) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7201(9) (McKinney Supp. 1983-84).

<sup>18</sup> N.J. STAT. ANN. § 32:1-35.21(a) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6652(a) (McKinney 1979).

<sup>19</sup> N.J. STAT. ANN. § 32:1-35.21(b) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6652(b) (McKinney 1979).

<sup>20</sup> N.J. STAT. ANN. § 32:1-35.26 (West Supp. 1983-84); Act of Dec. 8, 1978, ch. 792, 1979 N.Y. Laws 123, reprinted in N.Y. UNCONSOL. LAWS § 6631 app. (McKinney Supp. 1983-84).

<sup>21</sup> N.J. STAT. ANN. § 32:1-35.27c (West Supp. 1983-84); Act of June 23, 1980, ch. 470, 1980 N.Y. Laws 745, reprinted in N.Y. UNCONSOL. LAWS § 6631 app. (McKinney Supp. 1983-84).

<sup>22</sup> N.J. STAT. ANN. § 32:1-35.51 (West 1963 & Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6602 (McKinney 1979).

<sup>23</sup> 431 U.S. 1 (1977).

of the Port Authority that revenues and reserves pledged to those bonds would not be applied to any additional passenger railroad purpose beyond the basic Hudson Tubes, without the consent of the holders of such bonds, unless the Port Authority certified that the railroad was self-supporting or that deficits from the proposed additional passenger railroad facility would not, in the aggregate, exceed a specified statutory amount.<sup>24</sup> In 1973, this covenant was amended in bi-state concurrent legislation to preclude its prospective application to bonds issued after the effective date of the amendment.<sup>25</sup> In 1974, the States acted to retroactively repeal, without qualification, any application of this covenant,<sup>26</sup> giving rise to the litigation commenced in *United States Trust*. In that case, the United States Supreme Court reversed the New Jersey Supreme Court,<sup>27</sup> and held that the 1974 repeal, which operated retroactively, as opposed to the 1973 prospective repeal, was violative of the Contract Clause of the United States Constitution.<sup>28</sup>

### *The Port Authority Bus Programs*

#### *A. Legislation*

As a result of the Court's decision in *United States Trust*, the Port Authority undertook consideration of several programs in an effort to provide an effective mass transportation program consistent with bondholder's covenants and applicable law. In March 1978, Port Authority Chairman Alan Sagner proposed to Richard S. Page, Administrator of the Urban Mass Transportation Administration (UMTA), a joint effort on the part of the Port Authority and the State of New Jersey to finance and implement a northern New Jersey mass transit program.<sup>29</sup> This proposal

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<sup>24</sup> Act of Feb. 13, 1962, ch. 8, § 6, 1962 N.J. Laws 47; Act of March 27, 1962, ch. 209, § 6, 1962 N.Y. Laws 418.

<sup>25</sup> N.J. STAT. ANN. § 32:1-35.55 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 6606 (McKinney 1979).

<sup>26</sup> Act of April 30, 1974, ch. 25, § 1, 1974 N.J. Laws 54; Act of June 15, 1974, ch. 993, § 1, 1974 N.Y. Laws 1590.

<sup>27</sup> The New Jersey Supreme Court decision is reported at 69 N.J. 253, 353 A.2d 514 (1976).

<sup>28</sup> *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977). For more background on the bondholder's covenant dispute see *McTamaney, United States Trust Company of New York v. New Jersey: The Contract Clause in a Complex Society*, 46 FORDHAM L. REV. 1 (1977); Kraft & St. John, *The Contract Clause as the Guardian Against Legislative Impairments of Municipal Bondholder's Rights*, 6 SETON HALL L. REV. 48 (1974); Comment, *Repeal of Covenant Providing Security of Municipal Bond Violates Contract Clause: United States Trust Co. v. New Jersey*, 31 RUTGERS L. REV. 786 (1978).

<sup>29</sup> Letter from Alan Sagner, Chairman of The Port Authority of New York and New Jersey, to Richard S. Page, Administrator of the Urban Mass Transportation Administration (March 16, 1978).

provided for the purchase by the Port Authority of up to \$120 million of buses for use by the State of New Jersey. These expenditures could be counted by UMTA as the local share supporting up to \$480 million in federal funds which could then be applied by the State of New Jersey or its appropriate agencies to either bus or rail projects. The combination of Port Authority and federal funds made available up to \$600 million in bus/rail transit capital programs.<sup>30</sup> A similar program was envisioned for the State of New York. This proposal was endorsed by UMTA in May 1978.<sup>31</sup>

The successful implementation of this proposal was assisted by Congressional action on an amendment to the Urban Mass Transportation Act of 1964 (UMT Act), and was contingent upon the introduction and passage of authorizing legislation in New Jersey and New York.<sup>32</sup>

The UMT Act was amended in November 1978 to authorize the Secretary of Transportation to approve construction and improvement projects which utilize UMTA funds which previously had only been available for the purchase of buses and bus-related facilities.<sup>33</sup> The legislative history of this amendment reflects a clear Congressional recognition of the need for "flexibility in assisting jurisdictions to mold balanced capital improvement programs around local share funds whose use is restricted to bus purposes by a constitutionally protected covenant, such as in New Jersey and New York."<sup>34</sup> The amendment assisted the effectuation of Chairman Sagner's proposal by permitting the expenditure of local funds on bus and bus-related facilities to serve as the match for federal funds which could be applied to various non-bus capital improvements.

Prior to the passage of the UMT Act amendment, legislation to effectuate the Port Authority's participation in Chairman Sagner's proposed program was introduced in the Legislatures of the two States. The bi-state legislation, enacted March 1, 1979,<sup>35</sup> specifically authorized the Port Authority to acquire, develop, and finance, with the proceeds from

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<sup>30</sup> *Id.*

<sup>31</sup> Letter from Richard S. Page, Administrator of the Urban Mass Transportation Administration, to Alan Sagner, Chairman of The Port Authority of New York and New Jersey (May 15, 1978).

<sup>32</sup> N.J. STAT. ANN. §§ 32:2-23.27 to -23.42 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS §§ 7201-7217 (McKinney Supp. 1983-84).

<sup>33</sup> 49 U.S.C.A. §§ 1602(h), 1604(a)(4)(A) (West Supp. 1983).

<sup>34</sup> H.R. REP. NO. 1485, 95th Cong., 2d Sess. 56, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6575, 6632.

<sup>35</sup> N.J. STAT. ANN. §§ 32:2-23.27 to -23.42 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS §§ 7201-7217 (McKinney Supp. 1983-84).

its Consolidated Bonds up to \$240 million of buses<sup>36</sup> and ancillary bus facilities<sup>37</sup> in the two States. A maximum of \$120 million would be allocated in each State for the purpose of leasing, selling, or transferring these buses and ancillary bus facilities to any public authority, agency, commission, city or county thereof.<sup>38</sup>

In enacting the legislation authorizing the Port Authority to undertake a bus program, the Legislatures determined that "[t]he economic viability of the existing facilities operated by the [P]ort [A]uthority . . . is dependent upon the effective and efficient functioning of the transportation network of the northern New Jersey—New York metropolitan area and access to and proper utilization of such [P]ort [A]uthority facilities would be adversely affected if users of bus transportation were to find such transportation unavailable or significantly curtailed."<sup>39</sup>

The legislation provides that part of the consideration for any lease or transfer of buses and ancillary bus facilities by the Port Authority shall consist of an agreement by the lessee "to maintain and use such buses and ancillary bus facilities, or cause such buses and ancillary bus facilities to be maintained and used by others under agreement with the lessee, in the effective and efficient transportation of passengers" in accordance with the legislation.<sup>40</sup> Furthermore, the Port Authority may accept (and to date, has accepted) such agreement in lieu of any other consideration for

<sup>36</sup> The term "buses" is defined as "vehicles containing seats for [twelve] or more passengers which are designed for and regularly used in scheduled common carrier passenger mass transportation service on streets, highways, and exclusive busways and are not designed or used for railroad purposes." N.J. STAT. ANN. § 32:2-23.28(b) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7202(2) (McKinney Supp. 1983-84).

<sup>37</sup> The term "ancillary bus facilities" is defined as:

[A]ny facilities useful in the provision of service on line-haul regional or feeder bus routes, including but not limited to [a] fare collection, communication, signal and identification equipment, [b] equipment to aid in the provision of bus service to the elderly and handicapped, [c] maintenance, repair, and storage facilities and equipment, and [d] bus stations for use primarily by passengers traveling between New York and New Jersey; automobile parking lots for use by people who transfer to buses on line-haul regional bus routes or feeder bus routes; and shelters at roadside bus stops to afford waiting bus passengers protection from precipitation and wind.

N.J. STAT. ANN. § 32:2-23.28(a) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7201(1) (McKinney Supp. 1983-84).

<sup>38</sup> N.J. STAT. ANN. §§ 32:2-23.27 to -23.42 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS §§ 7201-7217 (McKinney Supp. 1983-84).

<sup>39</sup> N.J. STAT. ANN. § 32:2-23.27(d) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7201(4) (McKinney Supp. 1983-84).

<sup>40</sup> N.J. STAT. ANN. § 32:2-23.30 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7204 (McKinney Supp. 1983-84).

such lease or transfer.<sup>41</sup> In addition, both States covenanted with each other and with present and future Port Authority bondholders that:

(a) the lessee of buses or ancillary bus facilities leased, transferred or otherwise disposed of pursuant to this act shall be required to defend and to provide for indemnification, subject to appropriations or other funds which are or become legally available for this purpose, of the port authority against any liability of whatsoever form or nature as may be imposed upon the port authority by reason of the ownership, development, operation, maintenance, repair or use thereof or arising otherwise out of the port authority's interest therein; (b) the lessee shall be required to provide for and be responsible for the proper operation, maintenance, repair, and use of such buses and ancillary bus facilities leased, transferred or otherwise disposed of pursuant to this act and the port authority shall have no responsibility as to such operation, maintenance, repair or use; and (c) neither the states nor the port authority will apply to any purpose in connection with or relating to the operation, maintenance, repair or use of such buses or ancillary bus facilities leased, transferred or otherwise disposed of pursuant to this act, other than purposes in connection with the utilization of other port authority facilities by such buses and passenger information purposes, any of the rentals, tolls, fares, fees, charges, revenues, reserves or other funds of the port authority which have been or shall be pledged in whole or in part as security for obligations as security for which there may be or shall be pledged, in whole or in part, the general reserve fund of the port authority.<sup>42</sup>

The legislation also created a regional bus area limited to "that area in the States of New York and New Jersey which lies within a seventy-five mile radius of the [Port Authority] [B]us [T]erminal."<sup>43</sup> The buses to be purchased by the Port Authority and leased to the States or their designees can only be used on specific routes within and relating to the regional bus area.<sup>44</sup>

<sup>41</sup> N.J. STAT. ANN. § 32:2-23.30 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7204 (McKinney Supp. 1983-84).

<sup>42</sup> N.J. STAT. ANN. § 32:2-23.31 (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7205 (McKinney Supp. 1983-84).

<sup>43</sup> N.J. STAT. ANN. § 32:2-23.28(j) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7202(10) (McKinney Supp. 1983-84).

<sup>44</sup> The specified routes are defined as "feeder bus routes" and "line-haul regional bus routes." Feeder bus routes are defined as those "bus routes entirely within the regional bus area which connect within the port district with a bus stop on a line-haul regional bus route, a passenger ferry, or a railroad station." N.J. STAT. ANN. § 32:2-23.28(e) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS §



On January 7, 1982, the March 1, 1979 legislation was amended by the two States to permit the expenditure of up to an additional \$200 million for buses and ancillary bus facilities, with up to \$100 million allocated in each state.<sup>45</sup> In addition, subject to contracts with bondholders, any expenditures by the Port Authority in connection with the Port Authority Bus Programs were authorized to be made either through the provision of its revenues or reserves or from the proceeds of Consolidated Bonds.<sup>46</sup>

### *B. Implementation*

In New Jersey, a mass transportation capital program totalling \$600 million and dubbed TRANSPAC was being refined and readied for implementation.

Early in 1979, the New Jersey Commuter Operating Agency (COA) of the New Jersey Department of Transportation (NJDOT) submitted a

7202(5) (McKinney Supp. 1983-84). Line-haul regional bus routes are those "bus routes which are entirely within the regional bus area and which extend from a point outside the county in which the bus terminal is located to a point in such county." N.J. STAT. ANN. § 32:2-23.28(f) (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7202(6) (McKinney Supp. 1983-84).

<sup>45</sup> N.J. STAT. ANN. § 32:2-23.29a (West Supp. 1983-84); Act of June 29, 1981, ch. 314, §§ 15, 36, 1981 N.Y. Laws 526, 552-53, 565 amended by Act of April 12, 1982 ch. 62, 1982 N.Y. Laws 145, reprinted in N.Y. UNCONSOL. LAWS § 7206 app. (McKinney Supp. 1983-84).

<sup>46</sup> The additional expenditures were authorized to be made only after approval by the Governors of the two States, based upon a certification by the Port Authority, in addition to other appropriate certifications, that:

[T]he issuance of its consolidated bonds or the provision of its revenues or reserves in the amount of each such additional sum will not, during the ensuing 10 years, in the light of the authority's estimated expenditures in connection with each such additional sum, materially impair the sound credit standing of said authority or the investment status of its consolidated bonds or the ability of the said authority to fulfill any of its commitments, including those which require that it maintain its revenues and reserve funds in an amount adequate to permit it to discharge debt service on outstanding debt obligations, its other undertakings to the holders of consolidated bonds and its service obligations.

N.J. STAT. ANN. § 32:2-23.29a (West Supp. 1983-84); N.Y. UNCONSOL. LAWS § 7206 app. (McKinney Supp. 1983-84).

On March 8, 1979, and May 13, 1982, respectively, the Board of Commissioners of the Port Authority, pursuant to agreements with Port Authority bondholders, certified the Port Authority Bus Programs as additional facilities of the Port Authority and authorized the issuance of Consolidated Bonds for purposes of capital expenditures in connection with each facility. On May 13, 1982, the Board of Commissioners also certified the additional \$200 million of the Port Authority Bus Programs as required by the 1982 legislation. On June 9, 1982, the Governor of the State of New Jersey approved the additional expenditures based upon the legislative certification of the Board of Commissioners. A similar approval was issued by the Governor of the State of New York on May 28, 1982.

grant application to UMTA covering the purchase of 1,080 new transit and commuter buses.<sup>47</sup> This application was later revised to bring the total number of buses covered to 1,165.<sup>48</sup> In August of that year, UMTA provided a "Letter of No Prejudice"<sup>49</sup> which authorized NJDOT, within certain conditions, to purchase 1,165 buses utilizing up to \$120 million of Port Authority funds, as well as \$18.7 million of State bond proceeds, without prejudice to the eligibility of these expenditures for dedication as the local share for future UMTA grants for projects identified in NJDOT's multi-year program of capital improvements.<sup>50</sup>

Also during this period, the New Jersey Public Transportation Act of 1979<sup>51</sup> was enacted creating the New Jersey Transit Corporation<sup>52</sup> (NJT), a public corporation designated to replace the COA.<sup>53</sup> NJT was given the authority, *inter alia*, to acquire private transit carriers by purchase, condemnation, lease or otherwise.<sup>54</sup> This provision was particularly significant because NJT eventually acquired, with the assistance of the Port Authority, Transport of New Jersey (TNJ), a private corporation and wholly-owned subsidiary of Public Service Electric and Gas Company. At that time, TNJ was the largest supplier of bus transportation in the state.

The transition from COA to NJT was effectuated in December 1979. In April 1980, pursuant to the Port Authority Bus Programs and in response to Governor Byrne's request to aid in the acquisition of TNJ, the Port Authority Board of Commissioners authorized the purchase of buses and ancillary bus facilities in an amount not to exceed \$45 million,<sup>55</sup> and the lease of these buses and bus-related facilities to the State of New Jersey or its designee (subsequently NJT). Similar action was taken with respect to the State of New York. The Port Authority subsequently agreed to purchase from NJT at a total cost of \$28.1 million, 500 buses and 23

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<sup>47</sup> Application of the Commuter Operating Agency of the New Jersey Department of Transportation for a Capital Improvement Grant under the terms of the Urban Mass Transportation Act of 1964, as amended, to assist in the purchase of 1,080 New Buses (March 13, 1979) [hereinafter cited as *Grant Application*].

<sup>48</sup> First Revision to *Grant Application*, *supra* note 47 (June 29, 1979).

<sup>49</sup> Letter from Lillian C. Liburdi, Acting Deputy Administrator of the Urban Mass Transportation Administration, to Louis J. Gambaccini, Commissioner of the New Jersey Department of Transportation (August 15, 1979).

<sup>50</sup> *Id.*

<sup>51</sup> N.J. STAT. ANN. §§ 27:25-1 to -24 (West Supp. 1983-84).

<sup>52</sup> *Id.* § 27:25-4(a).

<sup>53</sup> *Id.* § 27:25-24.

<sup>54</sup> *Id.* § 27:25-13.

<sup>55</sup> The Port Authority of New York and New Jersey, Press Release No. 105-80 (April 30, 1980).

parcels of realty which NJT was acquiring from TNJ.<sup>56</sup> This Port Authority commitment enabled NJT to complete its arrangements to purchase the assets of TNJ at a cost of \$32.1 million.<sup>57</sup> Subsequent developments, however, made this Port Authority commitment unnecessary.

In June 1980, NJT solicited bids for Advanced Design Transit Buses. This solicitation set in motion the following two-phase transaction to provide for the purchase of buses by the Port Authority and their lease to NJT as contemplated by the Bus Programs legislation:

- Phase 1: NJT prepares the specifications for the buses and solicits bids. NJT and the Port Authority enter into a lease and other appropriate agreements for the buses.
- Phase 2: NJT receives the bids and enters into a contract for the manufacture and purchase of the buses with the successful bidder. NJT then assigns its rights and interests to purchase some or all of the buses to be manufactured under the contract to the Port Authority, which then leases them back to NJT under the agreement entered into in Phase 1.

Subsequent to the award of the Advanced Design Transit Bus contract to Grumman Flexible Corporation for 271 buses, NJT assigned its rights to purchase 113 of these buses to the Port Authority. NJT, which had been pursuing the utilization of UMTA funds for the purchase of TNJ, used part of this Port Authority commitment as the local share supporting a \$32.1 million UMTA grant.<sup>58</sup> The UMTA grant, in turn, covered the purchase of TNJ.<sup>59</sup> All agreements previously executed by the Port Authority and NJT in connection with the acquisition of the TNJ assets were thereafter declared null and void.<sup>60</sup> This series of events, while somewhat complex, did not affect the total level of capital funds available under the Bus Programs.

As of year-end 1983, the Port Authority has purchased or has agreed to purchase 943 buses at a total cost not to exceed \$147.6 million. These buses are or will be leased to NJT. Arrangements for the Port Authority's participation in the purchase and lease of 100 Articulated Buses and in an ancillary bus facility are under discussion.

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<sup>56</sup> New Jersey Transit Corp., Press Release (Sept. 17, 1980).

<sup>57</sup> *Id.*

<sup>58</sup> New Jersey Transit Corp., Press Release (Nov. 26, 1980).

<sup>59</sup> *Id.*

<sup>60</sup> Letter from Jerome C. Premo, Executive Director of New Jersey Transit Corp., to Peter C. Goldmark, Jr., Executive Director of the Port Authority of New York and New Jersey (Dec. 2, 1980).

The ability of NJT to leverage the bus purchases under the Port Authority Bus Programs and to use these purchases as the means to draw federal funds has enabled NJT to undertake substantial capital improvements to the State's mass transportation capital infrastructure. As of September 1983, NJT has received approximately \$628 million in federal obligations using approximately \$148 million of Port Authority bus purchases as local share for NJT.

### *Safe Harbor Leasing*

In 1981, the Economic Recovery Tax Act<sup>61</sup> (ERTA) added new provisions to the Internal Revenue Code of 1954<sup>62</sup> (IRC) which directly impacted on the public financing of mass commuting vehicles.<sup>63</sup> The first of these provisions involves the characterization of certain leases for allocation of depreciation deductions between the parties,<sup>64</sup> thereby permitting, through a so-called safe-harbor lease transaction, a tax exempt public transit operator to transfer previously unusable depreciation tax benefits to a private corporation in return for direct cash payment.<sup>65</sup> The other provisions effectively provide that a safe-harbor lease transaction will not restrict the financing of the acquisition of mass commuting vehicles on a tax-exempt basis.<sup>66</sup> In fact, to be qualified leased property for purposes of a safe-harbor lease, mass commuting vehicles are required to be "financed in whole or in part by obligations the interest on which is excludable from income under [section] 103(a)."<sup>67</sup>

As a result of the enactment of these provisions, NJT and the Port Authority began an in-depth analysis of the feasibility of leveraged lease financing alternatives for buses purchased by the Port Authority and leased to NJT under the Bus Programs. The end products of that analysis were appropriate safe-harbor lease and other agreements which permitted additional funding for New Jersey's mass transportation capital programs.

Qualified mass commuting vehicles, for purposes of both safe-harbor leasing and tax-exempt financing, are defined as "any bus, subway car,

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<sup>61</sup> Pub. L. No. 97-34, 95 Stat. 172 (1981).

<sup>62</sup> 26 U.S.C. §§ 1-9602 (1976 & Supp. V 1981).

<sup>63</sup> I.R.C. §§ 103(b)(4)(I), 103(b)(9) (Supp. V 1981); *Id.* § 168(f)(8) (amended 1982).

<sup>64</sup> I.R.C. § 168(f)(8) (Supp. V 1981) (amended 1982).

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* §§ 103(b)(4)(I), 103(b)(9) (Supp. V 1981).

<sup>67</sup> *Id.* § 168(f)(8)(D)(iii) (Supp. V 1981) (amended 1982); I.R.S. Letter Ruling 8309080 (Nov. 30, 1982).

rail car, ferry, or similar equipment . . . which is leased to a mass transit system wholly owned by [one] or more governmental units . . . and which is used by such system in providing mass commuting services.”<sup>68</sup> Under the proposed regulations,<sup>69</sup> to be used in mass commuting service, a vehicle must be used predominantly by business commuters on a day-to-day basis.<sup>70</sup> The proposed regulations state that a sightseeing service or service for the transportation of children to or from school will not qualify.<sup>71</sup> Additionally, the vehicle must be available on a regular basis for general public use.<sup>72</sup> If more than “an insubstantial portion of its use is reserved for the exclusive benefit of particular individuals or private groups,” the vehicle will not qualify.<sup>73</sup> Therefore, before these vehicles are placed into charter service, a careful analysis of the general public use requirements must be made.

ERTA expanded the list of facilities which may be financed by the issuance of tax-exempt Industrial Development Bonds (IDBs) to include qualified mass commuting vehicles.<sup>74</sup> An unlimited portion of the proceeds of these bonds, therefore, could be used to acquire mass commuting vehicles, which could be owned or used by a non-exempt person.<sup>75</sup> It should be noted that the mass commuting vehicle category in the list of exempt facilities will not be available for obligations issued after December 31, 1984.<sup>76</sup>

Aside from permitting unrestricted financing of mass commuting vehicles through the issuance of tax-exempt IDBs, the addition of mass commuting vehicles to the list of exempt facilities was apparently considered necessary to clarify the safe-harbor leasing requirement that the proceeds of tax-exempt obligations be expended in connection with the purchase of mass commuting vehicles<sup>77</sup> which are deemed to be used in the trade or business of the non-exempt safe-harbor lessor,<sup>78</sup> and conse-

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<sup>68</sup> *Id.* § 103(b)(9) (Supp. V 1981); I.R.S. Letter Ruling 8312037 (Dec. 17, 1982).

<sup>69</sup> Treas. Reg. § 1.103-8(j), 46 Fed. Reg. 63,326 (1981) (proposed Dec. 28, 1981), *reprinted in* 1982-1 C.B. 566-67.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> I.R.C. § 103(b)(4)(I) (Supp. V 1981).

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* § 103(b)(9)(B) (Supp. V 1981).

<sup>77</sup> *Id.* § 168(f)(8)(D)(iii) (Supp. V 1981) (amended 1982).

<sup>78</sup> *Id.* § 168(f)(8)(A)(i) (Supp. V 1981) (amended 1982).

quently the depreciable property of the lessor. The characterization of obligations issued to finance the acquisition of mass commuting vehicles as tax-exempt IDBs permits these vehicles to be considered qualified leased property for purposes of safe-harbor leasing.<sup>79</sup> Consistent with this intent, the temporary regulations also provide that the determination of whether an obligation constitutes an IDB shall be made without regard to the characterization of the transaction as a safe-harbor lease,<sup>80</sup> apparently obviating the necessity for the inclusion of all qualified mass commuting vehicles on the list of exempt facilities insofar as safe-harbor leasing is concerned.

ERTA provides a streamlined set of requirements to create a safe-harbor permitting the characterization of a transaction meeting these requirements as a lease, without regard to any other factors.<sup>81</sup> First, the property that is the subject of the lease must be "qualified leased property," which is defined to include qualified mass commuting vehicles financed in whole or in part with the proceeds of tax-exempt obligations.<sup>82</sup> It is unclear from the legislative history why this requirement was included, but the Treasury Department has limited its applicability by providing that this requirement can be satisfied by the provision of "[a]t least part (as, for example, 5 percent) of the financing for the purchase of such vehicle . . . from [the] proceeds of [these] obligations. . . ."<sup>83</sup> The other requirements set out in the temporary regulations are that the vehicle be recovery property, *i.e.* first placed in service by the lessee after December 31, 1980, and that the vehicle not have been the subject of a previous safe-harbor lease by the lessee.<sup>84</sup> It should be noted that qualified mass commuting vehicles do not have to be leased within three months of being placed in service, a requirement applicable to other types of qualified leased property.<sup>85</sup>

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<sup>79</sup> *Id.* § 103(b)(9) (Supp. V 1981).

<sup>80</sup> Treas. Reg. § 5c.103-2, T.D. 7800, 1982-1 C.B. 35, 36.

<sup>81</sup> I.R.C. § 168(f)(8) (Supp. V 1981) (amended 1982).

<sup>82</sup> *Id.* § 168(f)(8)(D) (Supp. V 1981) (amended 1982); I.R.S. Letter Ruling 8242009 (July 7, 1982).

<sup>83</sup> Treas. Reg. § 5c.168(f)(8)-6(b)(3), T.D. 7800, 1982-1 C.B. 35, 37-38. In I.R.S. Letter Ruling 8404028 (Oct. 21, 1983), where the total amount of tax-exempt financing constituted slightly more than one per cent of the taxpayer's total purchase price for the equipment, the I.R.S. held that the requirement that a qualified mass commuting vehicle will constitute qualified leased property if at least part of the financing for the purchase of the vehicle is derived from tax-exempt obligations was met.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

In order to qualify, the safe-harbor lessor must be either a corporation, other than a Subchapter S corporation or a personal holding company; a partnership (all of the partners of which are corporations); or a grantor trust (the grantor and all of the beneficiaries of which are corporations).<sup>86</sup> All of the parties to the transaction must have a written agreement which is characterized by them as a lease, and all must elect to have the safe-harbor provisions apply to that agreement.<sup>87</sup>

The lessor is also required to have a minimum "at risk" investment equal to at least ten per cent of the adjusted basis of the property when it is first placed in service under the lease and at all times during the term of the lease.<sup>88</sup> Under the temporary regulations, "the lessor's adjusted basis may not include that portion . . . of the cost of the vehicle to the lessee . . . that is financed, directly or indirectly with an Urban Mass Transportation Administration (UMTA) grant. . . ."<sup>89</sup> The regulation goes on to say that "[w]here a vehicle is included as part of a UMTA-funded project, 80% of the vehicle's cost will be deemed to be financed with an UMTA grant. . . ."<sup>90</sup> This provision was of critical importance to NJT because the buses provided under the Port Authority Bus Programs were also included by NJT in the local share to support federal funding under UMTA grants to NJT. Thus, since NJT determined it did not have sufficient local share funds, exclusive of Port Authority bus purchases, to support the amount of federal capital funds it might reasonably expect to receive, the income tax benefits which NJT could transfer by a safe-harbor lease to a corporate lessor were reduced by eighty per cent, with a consequent reduction in the amount of payment which it could receive. Amounts originating from a State, a political subdivision thereof, or a bi-state agency, however, are taken into account in computing the lessee's adjusted basis in the property "as if the lessee had paid or incurred such amounts,"<sup>91</sup> and are therefore included in the lessor's adjusted basis. This provision was also critical to NJT's safe-harbor leasing, because it was, in effect, a specific Treasury Department recognition of the Port Authority's role in the Port Authority Bus Programs which permitted NJT to accede to

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<sup>86</sup> I.R.C. § 168(f)(8)(B)(i) (Supp. V 1981) (amended 1982).

<sup>87</sup> *Id.* § 168(f)(8)(A) (Supp. V 1981) (amended 1982).

<sup>88</sup> *Id.* § 168(f)(8)(B)(ii) (Supp. V 1981) (amended 1982).

<sup>89</sup> Treas. Reg. § 5c.168(f)(8)-6(b)(3)(iii), T.D. 7800, 1982-1 C.B. 35, 38.

<sup>90</sup> *Id.* Cf. I.R.S. Letter Ruling 8229118 (April 23, 1982).

<sup>91</sup> *Id.*

the Port Authority's basis in the buses, subject to the federal grant limitation.

The final statutory requirement for a safe-harbor lease is that the term of the lease not exceed ninety per cent of the useful life, or one hundred and fifty per cent of the class life of the property as of January 1, 1981.<sup>92</sup>

The distillation of these statutory and regulatory provisions, in the context of the Bus Programs, produces a three phase safe-harbor leasing transaction effecting a tax benefit transfer as follows:

Phase 1: The Port Authority acquisition of a bus which is provided to NJT under the Port Authority Bus Programs.

Phase 2: NJT, as seller/lessee, transfers the bus, a qualified mass commuting vehicle, in a nominal "sale" to effect a tax benefit transfer to a private corporation, the buyer/lessor, in return for a cash payment and a level payment non-recourse note for the balance of the bus cost.

Phase 3: The private corporation nominally "leases" the bus back to NJT for lease rental payments exactly equal in timing and amount to the debt service due on the private corporation's non-recourse note issued in Phase 2. The nominal lease also contains a repurchase option at token value by which NJT acquires the bus at the end of the lease term.

Through this transaction, the private corporation becomes the owner of the bus for federal income tax purposes and is entitled to an annual depreciation deduction as well as a deduction for interest "paid" on the non-recourse note.<sup>93</sup> The corporation must, however, account for the rental payments it "receives" from NJT as income, and uses this income to directly offset its liability for payments on the non-recourse note. In actuality, the only money to change hands is the direct cash payment received by NJT upon its entering into the lease. The amount of this cash payment is a direct function of a determination of the present value of all deductions from and additions to the taxable income of the private corporation as of the beginning of the lease. This cash payment is then available to NJT for its other mass transportation infrastructure projects.

On December 31, 1981, NJT entered into a safe-harbor lease agreement with Albany International Corporation covering 244 Advanced De-

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<sup>92</sup> I.R.C. § 168(f)(8)(B)(iii) (Supp. V 1981) (amended 1982).

<sup>93</sup> *Id.* § 168(f)(8)(A)(ii) (Supp. V 1981) (amended 1982).



sign Buses, 202 of which were purchased by the Port Authority and leased to NJT under the Bus Programs. As a result of this transaction, NJT received a cash payment from Albany International of approximately \$855,000. On June 9, 1982, NJT and Thomas J. Lipton, Inc. entered into a safe-harbor lease agreement covering an additional 23 Advanced Design Buses which resulted in a cash payment from Lipton to NJT of approximately \$83,000. Five of these 23 buses were purchased by the Port Authority and leased to NJT. On May 26, 1983, and December 30, 1983, NJT entered into safe-harbor lease agreements including an additional 94 Advanced Design Transit Buses and 527 MCI Commuter Buses, resulting in cash payments to NJT in connection with these buses totaling approximately \$2.7 million.

The Tax Equity and Fiscal Responsibility Act of 1982<sup>94</sup> (TEFRA) caused sweeping revisions to many safe-harbor leasing provisions in an attempt to restrict the increasing popularity of tax benefit transfer lease transactions and reduce the perceived loss of tax revenues to the federal government.<sup>95</sup> Most of the revisions are not applicable to leases of qualified mass commuting vehicles; as long as the vehicle is placed in service prior to January 1, 1988, or, if not in service by that date (due to no fault of the lessee or lessor), if a binding agreement to purchase the vehicles was entered into between the parties prior to April 1, 1983, the ERTA safe-harbor provisions will continue to apply.<sup>96</sup> However, with the exception of certain transitional rules, TEFRA would limit the tax benefits acquired by the buyer/lessor in a safe-harbor lease of mass commuting vehicles, as well as any other qualified leased property, to provide that these benefits may not operate to reduce the taxpayer's liability for federal income tax by more than fifty per cent.<sup>97</sup> It would also appear that the cost recovery method specified in section 216 of TEFRA may be applicable to mass commuting vehicles which are placed in service after December 31, 1982, to the extent that these vehicles are financed by the proceeds of tax-exempt IDBs issued after June 30, 1982.<sup>98</sup>

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<sup>94</sup> Pub. L. No. 97-248, 1982 U.S. CODE CONG. & AD. NEWS (96 Stat.) 419.

<sup>95</sup> S. REP. NO. 494, 97th Cong., 2nd Sess. 138, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 781, 901-902.

<sup>96</sup> Pub. L. No. 97-248, § 208(d)(5), 1982 U.S. CODE CONG. & AD. NEWS (96 Stat.) 436-37.

<sup>97</sup> *Id.* § 208(a)(1), 1982 U.S. CODE CONG. & AD. NEWS (96 Stat.) 432-33 (to be codified at I.R.C. § 168(i)(1)).

<sup>98</sup> *Id.* § 216, 1982 U.S. CODE CONG. & AD. NEWS (96 Stat.) 470-72 (to be codified at I.R.C. § 168 (f)(12)).

The continuing economic impact of the TEFRA amendments on NJT's future plans is difficult to assess. At present, NJT intends to proceed with plans to safe-harbor lease the balance of 700 MCI commuter coaches and any new articulated buses it receives by reason of its participation in the Port Authority Bus Programs. Generally, the TEFRA provisions have not caused a softening in the market for this form of safe-harbor lease transaction involving mass commuting vehicles. Furthermore, recent Congressional proposals with respect to sale/leaseback transactions provide exemptions for mass commuting vehicles.<sup>99</sup>

### *Conclusion*

The Port Authority Bus Programs present an excellent case study of the benefits to be derived by governmental entities when public and private equity is blended through creative financing to reduce the cost of providing essential services. The role of the Port Authority in the Bus Programs demonstrates the vital part which that agency plays in assisting both New Jersey and New York with their mass transportation capital infrastructure needs. The encouragement of the public-private partnership through continued and expanded federal and local incentives is essential to the effective provision of governmental services.

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<sup>99</sup> S. 2062, 98th Cong., 1st Sess. (1983); H.R. 4170, 98th Cong., 1st Sess. (1983).