

## MEMORANDUM

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**TO:** Susan Anthony  
Mark T. Kaminski  
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**FROM:** Reed Groethe  
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**DATE:** June 21, 2013

**RE:** **Costs for Green Infrastructure: Treatment as Capital Costs and Financing with Borrowing Obligations**

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### QUESTION PRESENTED

The metropolitan sewerage commission (the “**Commission**”) of the Milwaukee Metropolitan Sewerage District (the “**District**”) has adopted a policy of supporting practices or improvements that restore a more natural hydrology, thereby increasing the capacity for stormwater to be retained in the soil and reducing the extent to which stormwater is collected and treated by the District’s collection and treatment system. Consideration is being given to the District making payments to landowners for specified practices or improvements in connection with this policy. You have asked whether the District may treat those payments as capital costs for statutory purposes and whether the District may finance the costs of those payments through its issuance of borrowing obligations.

In this memorandum, we first review the District’s policy, including the practices and improvements described in the policy documents. Then we consider the

circumstances under which the District's payments for those practices and improvements may be treated as capital costs for statutory purposes. In that respect, we discuss the importance of those payments being made in exchange for interests in real property and the manner in which the District can achieve that result. We also discuss the importance of the Commission making findings and determinations in support of treating those payments as capital costs. Finally, we discuss the extent to which the District may issue general obligations or revenue obligations to pay for those costs and the related matter of whether interest on those obligations may be excluded from gross income for federal income tax purposes.

### **SUMMARY**

A basis exists for the District to treat its payments for specific practices or improvements as capital costs for statutory purposes. To do so, the transactions should be structured so that the District acquires interests in real property, and the Commission should make reasonably supported findings and determinations to establish that the property interests acquired are used as part of the District's sewerage system.

The District has the power to finance these payments with one or more types of borrowing obligations, but as a practical matter the District should use general obligation promissory notes. Whether interest on the borrowing obligations may be excluded from gross income for federal income tax purposes will depend on several factors.

### **ANALYSIS**

#### **I. The District's Green Infrastructure Policy**

First, we review the District's policy and the nature of the practices and improvements that the policy promotes.

##### **I.1. Practices and Improvements**

The District's policy is set forth in Commission Policy 1-11.05, issued on July 23, 2012, and entitled "MMSD Infrastructure Includes Green Infrastructure" (the "**Green Infrastructure Policy**"). The policy promotes the use of practices and improvements that retain or infiltrate stormwater and snowmelt, and thereby reduce or delay their collection and treatment and reduce flooding of waterways, as a cost-effective, sustainable, and environmentally friendly approach to wet weather management.

For reference, Commission File No. 12-106-7, containing the Green Infrastructure Policy and the related summary, background, and resolution, is attached as Exhibit A.

The Green Infrastructure Policy specifically identifies the following practices and improvements (“**green infrastructure**”):

- **Greenways:** riparian and nonriparian buffer zones and strips that store and drain stormwater runoff into the ground naturally
- **Rain gardens:** gardens that are watered by collected or pooled stormwater runoff, slowly infiltrating water into the ground along root pathways
- **Wetlands:** areas that have soils that are inundated or saturated for part of the year or the entire year
- **Trees:** trees can hold rainwater on their leaves and branches, infiltrate it into the ground, absorb it through root systems, and evapotranspire it to the atmosphere
- **Green roofs:** partially or completely planted roofs with vegetation growing in soil or other growing media to hold rainwater
- **Bioswales:** landscape features that capture and infiltrate runoff and can also remove its pollutants
- **Porous pavement:** pavement that can reduce and infiltrate surface runoff through its permeable surface into a stone or filter medium below
- **Native landscaping:** the use of native plants that can tolerate drought and flooding cycles because of deep roots and climate specific adaptations
- **Rainwater catchment:** the capture and storage of water, potentially for reuse later
- **Green alleys, streets, and parking lots:** public infrastructure features that can channel, infiltrate, and evapotranspire water
- **Greenseams®:** preservation and protection of lands with hydric soils, to buffer waterways

Although green infrastructure could be installed or practiced solely on District-owned land, for the Green Infrastructure Policy to be significant in achieving its

purpose, green infrastructure must be installed or practiced extensively on land that is not owned by the District. Accordingly, one way for the District to implement its policy would be to make payments to landowners for green infrastructure practices and improvements.

## **1.2. Discharge Permit**

The District is required to use green infrastructure to comply with state environmental law, by virtue of its current Wisconsin Pollutant Discharge Elimination System Permit (the “**Permit**”). The Permit, which was issued by the State of Wisconsin Department of Natural Resources and became effective as of January 8, 2013, requires the District to achieve specified goals concerning green infrastructure practices and improvements.

Section 4.10 of the Permit states, “Beginning in calendar year 2013, and in each calendar year thereafter during the permit term, the [District], working with partners as appropriate, must ensure that green infrastructure practices/control measures are put in place and maintained in the [District’s] service area. The practices/control measures put in place in 2013 must cumulatively have a design retention capacity of at least 1 million gallons, and each following calendar year during the permit term an additional 1 million gallons of green infrastructure retention capacity must be put in place.”

Section 4.9 of the Permit includes a directive that the District “will work with its regional partners to develop methods for tracking green infrastructure implementation and to pilot the development of a green infrastructure portfolio standard. The purpose of the tracking system and standard is to develop a system that can be used to assess and set goals for the increasing use of green infrastructure over time in order to manage wet weather flows.”

The District is not required to use green infrastructure by federal environmental law, but the United States Environmental Protection Agency’s website encourages the use of green infrastructure. The website explains that “Green infrastructure uses vegetation, soils, and natural processes to manage water and create healthier urban environments. At the scale of a city or county, green infrastructure refers to the patchwork of natural areas that provides habitat, flood protection, cleaner air, and cleaner water. At the scale of a neighborhood or site, green infrastructure refers to stormwater management systems that mimic nature by soaking up and storing water.” The website describes green infrastructure elements that are similar, but not identical, to the elements of green infrastructure described in the District’s Green Infrastructure Policy.

## **2. Treatment of Green Infrastructure as a Capital Cost**

A basis exists for the District to treat certain payments for green infrastructure as capital costs for statutory purposes. For the District to do so, the transactions should be structured so that the District acquires interests in real property, and the Commission should make reasonably supported legislative findings and determinations to establish that the property interests acquired are used as part of the District's sewerage system.

### **2.1. Part of Sewerage System**

For payments for green infrastructure to be treated as capital costs for statutory purposes, the green infrastructure must be part of the District's sewerage system.

The District is created under subchapter II of chapter 200 of the Wisconsin Statutes, which (among other things) establishes the general duty of the Commission. In setting forth the Commission's general duty, the statutes require that the Commission "shall . . . [p]roject, plan, design, construct, maintain and operate a sewerage system for the collection, transmission and disposal of all sewage and drainage of the sewerage service area including, either as an integrated or as a separate feature of the system, the collection, transmission and disposal of storm water and groundwater [and] [a]bate combined sewer overflows to the extent necessary to comply with federal or state law." Wis. Stat. § 200.31.

The term "sewerage system" is defined to mean "all facilities of the [District] for collection, transportation, storage, pumping, treatment and final disposition of sewage"; however, the term "does not include any private on-site wastewater treatment system, as defined in s. 145.01 (12), or any local sewer." Wis. Stat. § 200.21 (11).

There can be no doubt the term "sewerage system" includes the well-known physical components of a sewerage system—pipes, pumps, and treatment works, for example—but does the term also include green infrastructure, which is not directly connected to the physical components of a sewerage system and does not directly involve sewage? A close examination of the statutory terminology shows that green infrastructure may be part of a sewerage system.

Part of the general duty of the Commission concerns the abatement of combined sewer overflows. Green infrastructure may be useful in the abatement of combined sewer overflows; however, only a portion of the District's territory is served by combined sewers, so the Commission's duty with regard to combined

sewers does not provide an adequate basis for the Green Infrastructure Policy, which applies to all territory served by the District.

The other part of the general duty of the Commission concerns the sewerage system. Although the term “sewerage system” is statutorily defined, the statutory definition does not include some elements of a sewerage system that are described in the statement of the general duty of the Commission. Because of the paramount importance of the Commission fulfilling its general duty, the statutory definition must be interpreted to include the elements described in the statement of the general duty.

The statutory definition provides that the term “sewerage system” means “all facilities of the [District] for collection, transportation, storage, pumping, treatment and final disposition of sewage.” The general duty refers to “a sewerage system for the collection, transmission and disposal of all sewage and drainage of the sewerage service area including, either as an integrated or as a separate feature of the system, the collection, transmission and disposal of storm water and groundwater.” One difference between the statutory definition and the general duty is that the general duty expressly acknowledges that features of the system may be integrated or separate. Another difference is that the general duty expressly describes drainage, stormwater, and groundwater, which certainly should be understood to be part of the term “sewage”, as used in the definition of the term “sewerage system”. *See, e.g.*, Wis. Stat. § 281.01 (13). In addition, the general duty recognizes that collection, transmission, and disposal of storm water and groundwater can be a “feature” of the sewerage system.

These differences are significant, as applied to green infrastructure. First, green infrastructure is not a physically integrated feature of the system. Rather, it is separate from the pipes, pumps, treatment works, and other physically integrated features of the system. Second, green infrastructure concerns not just sewage but drainage, stormwater, and groundwater.

Accordingly, the term “sewerage system” should be interpreted to include elements that are physically separate features of the system and elements that concern drainage, stormwater, or groundwater. Guided by this interpretation, the Commission should have a reasonable basis to find and determine that green infrastructure is part of a sewerage system. For example, facts and reasoning could be set forth to support conclusions that (1) green infrastructure facilitates the collection, transmission, and disposal of drainage and stormwater and also assists in the collection of groundwater, and is thus a feature of the District’s sewerage system, and (2) by diverting or delaying stormwater from entering the

District's collection and treatment system, green infrastructure results in an extension or improvement of the capacity or efficiency of the sewerage system.

## **2.2. Acquiring a Property Interest**

The definition of the term "sewerage system" speaks of "all facilities of the [District]". In two respects this language embodies the notion that, for payments for green infrastructure to be treated as part of the sewerage system, the District must acquire property interests in the green infrastructure.

First, the phrase "of the District" connotes possession or ownership by the District, which strongly suggests that green infrastructure should not be treated as part of the sewerage system unless the District acquires property interests in the green infrastructure.

Second, because the term "facilities" is not defined by statute, Wisconsin courts will look to recognized dictionary definitions to determine the common and ordinary meanings of the word. Although the term "facilities" is commonly used to refer to buildings and improvements situated on real property, the term is also understood more broadly to include anything that facilitates an action or process, American Heritage Dictionary, 4<sup>th</sup> ed. (2004), and thus could conceivably include interests in personal property or intangible property. A broader definition may not apply, however. The Appellate Court of Connecticut concluded that using the broader definition of the term "facilities" was "clearly" not the intention of the drafters of the regulation in question in the case of *Mt. Brook Ass'n v. Zoning Bd. Of Appeals of Wallingford*, 37 A.3d 748, 755 (Conn. App. Ct. 2012). The court reasoned that using the broader definition caused "the list of what falls within the definition of recreation facilities . . . to be virtually limitless." *Id.* Although the Connecticut court's decision is instructive, there does not appear to be case law in Wisconsin that prohibits the use of the broader definition of the term "facilities".

Thus, the term "facilities" as broadly defined could include any type of property interest, and a more restrained definition would align with common usage. We believe it is prudent for the District to recognize that a court might use the more restrained definition. Accordingly, we recommend that the District acquire property interests in real property to support its treatment of green infrastructure as part of its sewerage system.

Our recommendation also recognizes that green infrastructure intrinsically involves an element of novelty to the extent it is unlike the well-known physical components of pipes, pumps, treatment works, and so forth. The District would compound the novelty by treating green-infrastructure interests in personal property or intangible property as part of its sewerage system. Moreover, every

green infrastructure practice or improvement will be associated with a specific physical location, so it should be practical for the District to acquire interests in real property.

### **2.3. Capital Costs for Statutory Purposes**

The matter of acquiring property interests is also important under the definition of the term “capital costs”.

The term “capital costs” is defined to mean “the cost of acquiring, purchasing, adding to, leasing, planning, designing, constructing, extending and improving all or any part of a sewerage system and of paying principal, interest or premiums on any indebtedness incurred for these purposes.” Wis. Stat. § 200.21 (1). This statutory language is more limited than the language establishing the general duty of the Commission. An action that is within the general duty of the Commission may involve costs that are not capital costs.

Analytically, in order for costs of green infrastructure to be capital costs, those costs must relate to the District’s sewerage system—but, as has already been discussed, a basis exists for the Commission to find and determine that green infrastructure is part of the sewerage system.

It also is the case, for several reasons, that the costs for green infrastructure (excluding perhaps costs for planning and design) should not be treated as capital costs unless the District acquires property interests. First, as previously mentioned, the phrase “all facilities of the [District]”, which is part of the definition of the term “sewerage system”, implies possession or ownership by the District, and thus the District needs to acquire property interests. Second, all the gerunds used in the definition of “capital costs”—“acquiring, purchasing, adding to, leasing, planning, designing, constructing, extending and improving”—relate to actions taken with regard to property. Third, under accounting conventions, property must have a useful life of more than one year to be treated as a capital cost. It would be prudent to expect that accounting conventions may inform a court’s judgment in applying this statutory definition such that a court would not allow costs for property that is exhausted within a year to be treated as a capital cost.

Accordingly, each transaction, in order to be funded as a capital expenditure, should be structured so that the District acquires a property interest with a useful life greater than one year. (We note, however, that additional requirements may apply in order for a specific transaction to be funded as a capital expenditure. For example, you have advised us that the District’s current policy requires that property funded as a capital expenditure must have a useful life of ten years or

more and a cost greater than \$25,000; otherwise, the property is funded under the operation and maintenance budget.)

#### **2.4. Deference Given to Findings and Determinations**

Correspondingly, the Commission should make reasonably supported legislative findings and determinations to establish that the property interests acquired are used as part of the District's sewerage system.

Case law shows that Wisconsin courts afford much deference to reasonably supported legislative findings; however, Wisconsin courts review decisions involving statutory interpretation de novo.

Wisconsin courts "afford substantial deference to any exercise of legislative power", and the Wisconsin Supreme Court has recognized that "courts should be reluctant to invalidate . . . legislative decisions." *Donaldson v. Bd. of Comm'rs*, 680 N.W.2d 762, 785 (Wis. 2004). For example, when a common council determines whether a certain purpose is a "public purpose" in connection with appropriating public funds, the court defers to the decisions of the common council and does not "look underneath the reasons it has articulated." *Alexander v. City of Madison*, 634 N.W.2d 577, 580 (Wis. Ct. App. 2001). This is similar to the Commission's pending determination of what constitutes a sewerage system: as long as the Commission articulates reasons for its determination, the courts will likely defer to the Commission's findings and will not look underneath the reasons the Commission articulates.

Further, when Wisconsin courts review the performance of a legislative function, the decision is presumed correct, and judicial review is limited to "(1) whether the [legislative body] kept within its jurisdiction; (2) whether it proceeded on a correct theory of law; (3) whether its action was arbitrary, oppressive, or unreasonable and represented its will and not its judgment; and (4) whether the evidence was such that the [legislative body] might reasonably make the determination in question." *Donaldson* at 765. Although a court will defer to the Commission's findings, the Commission may not act arbitrarily and capriciously. To avoid a determination that it has acted arbitrarily and capriciously, the Commission must make reasoned decisions that include the contemplation of criteria that might not support its position. *See id.*

Decisions involving statutory interpretation do not receive the same deference as legislative findings. If a court considers the Commission's determination of what falls within the definition of "sewerage facilities" under Wis. Stat. § 200.21 (11) a decision that requires statutory interpretation, the court will likely review the Commission's determination de novo. *See Donaldson* at 768 ("Statutory

interpretation is a question of law that we review de novo.”). The Supreme Court of Wisconsin has found, however, in cases where interpretation of a statute “may require an understanding of certain concepts of utility law and of the charges, rules and practices of sewerage districts, subjects within the expertise of [an administrative agency,] the administrative agency’s analysis of the statutory issues will often aid the court in its decision-making process.” *Brookfield v. Milwaukee Metro. Sewerage Dist.*, 491 N.W.2d 484, 492-93 (Wis. 1992).

It is possible that the same deference will be given to the Commission that is given to an administrative agency such that the Commission’s findings, even on an issue involving statutory interpretation, will be afforded some weight by the court. In this situation, statutory interpretation is unquestionably involved, but factual findings and determinations can be helpful in establishing the manner in which green infrastructure facilitates the collection, transmission, and disposal of drainage and stormwater and also assists in the collection of groundwater.

## **2.5. Suggested Findings and Determinations**

We have in several instances recommended that the Commission make findings and determinations in support of treating payments for green infrastructure as capital costs for statutory purposes. Here are specific suggestions, for your consideration, regarding findings and determinations.

First, we recommend that the Commission clearly identify its actions as findings and determinations, so there can be no doubt that the Commission is acting in the performance of its legislative function. For example, the Commission’s action could include the following language: “The Commission, in the performance of its legislative function, makes the following findings and determinations.”

Second, the Commission should note that the sewerage system may include elements that are integrated or physically separate features and elements that concern, not just sewage, but drainage, stormwater, or groundwater. As mentioned in section 2.1, we recommend that the Commission make findings and determinations that green infrastructure is part of a sewerage system. The Commission could do this, for example, by reciting facts and reasoning in support of conclusions that (1) green infrastructure facilitates the collection, transmission, and disposal of drainage and stormwater and also assists in the collection of groundwater, and is thus a feature of the District’s sewerage system, and (2) by diverting or delaying stormwater from entering the District’s collection and treatment system, green infrastructure results in an extension or improvement of the capacity or efficiency of the sewerage system.

Third, the Commission should make legislative findings and determinations that property interests acquired by the District in specific green infrastructure (excluding any private on-site wastewater treatment system or local sewer) are part of the facilities of the District for collection, transportation, storage, pumping, treatment, and final disposition of sewage.

Because the Green Infrastructure Policy identifies the practices and improvements that constitute green infrastructure elements, one approach would be to amend and restate the Green Infrastructure Policy to expressly include findings and determinations such as those suggested above. The findings and determinations could also be included in a separate resolution adopted by the Commission; for example, they could be included in a resolution adopted in connection with a note financing.

### **3. Property Interests in Green Infrastructure**

As previously discussed, it is important that the District's payments to landowners be made in exchange for real-property interests in the green infrastructure practices and improvements. Whether or not they do may vary from case to case, but in almost all cases, those payments **can** be made for property interests by structuring each transaction as the acquisition or purchase of a conservation easement under section 700.40 of the Wisconsin Statutes or, where acquiring a conservation easement may be impracticable, as the acquisition or purchase of covenants running with the land.

#### **3.1. Model: The Greenseams Program**

The Greenseams program provides an example of the District's acquiring property interests. Under the Greenseams model, the District's objective is to acquire a conservation easement in lands with hydric soils. The conservation easement keeps the lands from being developed and used in a way that interferes with its capacity to infiltrate stormwater and snowmelt. The District could acquire a conservation easement directly from a fee owner of the land, but as a practical matter the District may need to acquire the fee interest first. Once the District records a conservation easement, it can transfer the remaining interests in the land to another user. The conservation easement acquired or retained by the District is a well-established property right.

#### **3.2. The Green Infrastructure Program**

Under the green infrastructure program, the essential components of the transaction between the District and a landowner would be the District's payment of money to the landowner, in exchange for one or more promises by the

landowner: to maintain a green infrastructure practice at the landowner's property, or to allow the District to do so; to install a green infrastructure improvement at the landowner's property, or to allow the District to do so; or to maintain the improvement (and related practices) over time, or to allow the District to do so. The District's payment schedule would be specified: for example, one installment might be paid at the outset of the transaction, another paid upon the completion of the improvement, and still others paid over time. (It is possible that the schedule of payments would affect the capital nature of the payments, but we have not explored that point.) Similarly, the duration of the landowner's promises would also be specified; for example, they might last ten, twenty, or thirty years, or they might be perpetual (and for the reasons discussed in section 2.3 of this memorandum, they should last more than one year). It would also be helpful to state which party, the District or the landowner, would own the green infrastructure improvement. Lastly, the transaction might include additional components, such as specified remedies for the landowner's failure to keep its promises. In contrast with the Greenseams program, the District would not hold the fee interest in the landowner's property at any point in time.

Section 700.40 of the Wisconsin Statutes is Wisconsin's version of the uniform conservation easement act. (To date, a version of the act has been adopted in 21 states, including Wisconsin, plus the District of Columbia and the U.S. Virgin Islands.) As section 700.40 makes clear, in almost all cases the green infrastructure transaction between the District and the landowner could be embodied in a conservation easement, and a conservation easement is an interest in real property.

### **3.3. Conservation Easements: Section 700.40 of Wisconsin Statutes**

Under section 700.40, a conservation easement is "a holder's nonpossessory interest in real property imposing any limitation or affirmative obligation the purpose of which includes retaining or protecting natural, scenic or open space values of real property, assuring the availability of real property for agricultural, forest, recreational or open space use, protecting natural resources, maintaining or enhancing air or water quality, preserving a burial site, as defined in s. 157.70 (1) (b), or preserving the historical, architectural, archaeological or cultural aspects of real property." Wis. Stat. § 700.40 (1) (a).

Several aspects of this definition are worth noting: First, a conservation easement is an interest in real property. Second, a conservation easement can include any combination of rights and obligations, in favor of either or both parties (and, among other things, it can impose affirmative obligations on the landowner). Third, the stated purposes of a conservation easement are highly compatible with

the green infrastructure program: “retaining or protecting natural . . . values of real property, . . . protecting natural resources, [and] maintaining or enhancing . . . water quality.” Equally important, the purposes are stated broadly, so that no specific improvement or practice is required (and, conversely, no specific improvement or practice is excluded).

The holder of a conservation easement must be either:

- a “governmental body empowered to hold an interest in real property under the laws of [Wisconsin] or the United States”, or
- a charitable entity having one or more of the purposes stated in the relevant part of the statute.

Wis. Stat. § 700.40 (1) (b). The District would qualify under the first alternative: the District is “a municipal body corporate”, Wis. Stat. § 200.29 (3), and the District has broad, general power to acquire real property. Wis. Stat. § 200.43 (1).

Finally, a conservation easement is valid even though it may include (or it may lack) various features that would have been problematic (or required) under traditional common law. For example, a conservation easement would be valid even if:

- It is held by the holder personally (is an easement “in gross”, to use common law terminology) and does not benefit a separate parcel owned by the holder (is not an easement “appurtenant”).
- It imposes a negative or restrictive obligation on the landowner.
- It imposes an affirmative obligation, either on the landowner or on the holder.
- There is no privity of estate or privity of contract (whether as to the current landowner or any subsequent landowner).
- It is otherwise of a character that was not recognized under traditional common law.

Wis. Stat. § 700.40 (4).

In summary, the District could employ conservation easements to embody almost all the green infrastructure transactions between the District and landowners, and the conservation easements acquired by the District would constitute interests in real property. As discussed in section 2.5 of this memorandum, the Commission would make findings and determinations that the interests in real

property embodied by the conservation easements (along with any green infrastructure improvements on real property owned by the District, to the extent applicable in specific cases) are part of the District's facilities for the collection, transportation, storage, pumping, treatment, and final disposition of sewage.

**Formal requirements: Statute of frauds.** As with any interest in land, a conservation easement must satisfy the "statute of frauds" in order to be valid as between the District and a landowner. For a transaction affecting an interest in land, the statute of frauds requires a **written instrument** that:

- Identifies the parties,
- Identifies the land,
- Identifies the interest conveyed and any material term, condition, reservation, exception, or contingency upon which the interest is to arise, continue, or be extinguished, limited, or encumbered,
- Is signed by or on behalf of each grantor, and (i) in certain cases, is signed by or on behalf of the other parties to the transaction, or (ii) in certain cases involving the interest of a married person in a homestead, is signed or joined in separately by or on behalf of each spouse, and
- Is delivered.

Wis. Stat. § 706.02 (1).

**Formal requirements: Recording and legal description.** As a general matter, recording is not required to make an interest in real property valid as between the original parties to the interest; rather, recording is required (subject to various statutory exceptions) in order to make the interest valid as against third parties (such as subsequent good-faith purchasers for value) and to extend the statutory time periods for bringing or defending an action on the interest. *See* Wis. Stat. §§ 706.08, 706.09, and 893.33; *see also Turner v. Taylor*, 673 N.W.2d 716 (Wis. Ct. App. 2003).

However, in the case of a conservation easement under section 700.40, recording is required by section 700.40 itself. Wis. Stat. § 700.40 (2) (b).

To be recorded, a conservation easement must contain a full legal description (among other formal requirements). Wis. Stat. § 706.05 (2m). A precisely-articulated "metes and bounds" description is one type of legal description, but it is not the only type: a legal description can also be based on a reference to quarter

section, section, township and range; to government lot; to subdivision or condominium plat; or to certified survey map. Wis. Stat. §§ 66.0217 (1) (c) and 706.01 (7r).

### **3.4. Alternative: Covenants Running with the Land**

As an alternative to a conservation easement under section 700.40, the District and the landowner could provide in a written instrument that their agreements constitute covenants (or easements and covenants, depending upon the specific agreements) “running with the land” in respect of the landowner’s interest in the land. (If an easement or covenant “runs with the land”, then it is binding upon subsequent owners of the land, even if it is not specifically referenced in the conveyance to the subsequent owner.)

In the context of judicial actions and remedies affecting real property—such as a declaration of interest in real property (formerly known as a “quiet title” proceeding), extinguishment of an interest, partition, restraint of encroachment upon or interference with an interest, or special performance or other enforcement of an interest—the term “interest in real property” includes both easements as well as “rights under covenants running with the land”. Wis. Stat. §§ 840.01 (1) and 840.03; *see also Village of Hobart v. Oneida Tribe*, 736 N.W.2d 896, 898 (Wis. Ct. App. 2007) (terms “security interest”, “lien”, “profit”, and “covenant” refer to property rights). As an aside, licenses are specifically *excluded* from the term “interest in real property”. Wis. Stat. § 840.01 (2).

Accordingly, the District’s payments to a landowner for covenants (or easements and covenants) running with the land, even if the covenants are not included in a conservation easement under section 700.40, would still result in the acquisition of an interest in real property. There is nothing in section 700.40 that is somehow exclusive or preemptive of covenants (or easements and covenants) that pertain to subjects contained in section 700.40; section 700.40 makes clear that it does not invalidate any other interest in real property that is otherwise enforceable under Wisconsin law, whether the other interest is labeled a covenant, an easement, or even a conservation easement. Wis. Stat. § 700.40 (5).

The instrument containing the covenants would have to satisfy the statute of frauds (discussed above), but it would not have to be recorded. (If the instrument is not recorded, we would recommend that it specifically prohibit conveyance of the landowner’s interest unless and until the landowner has given its purchaser written notice of the covenants, and the purchaser has acknowledged the covenants in writing—or otherwise include some provision for putting purchasers

on actual notice of the covenants, and for providing the District with evidence of the same).

The instrument also would not have to contain a full legal description. The statute of frauds requires that the land be identified, Wis. Stat. § 706.02 (1) (b), but this does not necessarily require a full legal description, as long as the land is identified with “reasonable certainty”. *Anderson v. Quinn*, 743 N.W.2d 492, 500 (Wis. Ct. App. 2007) (reasonable certainty means that by the aid of the facts and circumstances surrounding the parties at the time, a court can determine with reasonable certainty the land which is to be conveyed). For example, depending upon the specific real property and the interest to be acquired, identification might be accomplished by a distinct address, a distinct tax parcel identification number, distinct references to specific streets, highways, and blocks, attachment of a clearly labeled map, or some other method that clearly described and distinguished the affected real property.

Although covenants running with the land are an available alternative, we still recommend that the District acquire a conservation easement whenever practicable, because:

- The purposes of section 700.40 (“retaining or protecting natural . . . values of real property, . . . protecting natural resources, [and] maintaining or enhancing . . . water quality”), and the allowable content of a conservation easement (“any limitation or affirmative obligation”, including “affirmative obligations upon the owner of any interest in the burdened property”) are so highly compatible with the green infrastructure program.
- The legal-description requirement applicable to conservation easements is not as prohibitive as it may appear. As one illustration, if a green infrastructure improvement is located on a larger parcel (for which a full legal description is already readily available), then a discrete legal description of the specific improvement itself may not be required; for example, the existing legal description of the parcel, plus a drawing and/or verbal description of the location of the improvement, may be sufficient.
- As discussed above, section 700.40 makes a number of common law categories and requirements—such as privity of estate and contract—inapplicable to conservation easements. In contrast, there is a degree of risk (however small) that a court might impose these same categories or requirements (or might apply additional common law presumptions) to a set of agreements purporting to constitute covenants running with the land; if the categories or

requirements are found lacking (or the presumptions not outweighed by other factors), then the agreements might be found invalid as an interest in real property. In other words, while it is clear that covenants running with the land constitute an interest in real property, it may vary from case to case as to whether a set of agreements in a written instrument constitute covenants running with the land.

- Lastly, at a theoretical level there is something inconsistent in providing that a written instrument contains covenants running with the land but not recording the instrument that contains the covenants, which a court might find (explicitly or implicitly) objectionable. In contrast, the purposes and allowable content of conservation easements are clearly established in section 700.40.

Ultimately, whether the District proceeds with a conservation easement or with covenants running with the land will require a case-by-case analysis, depending upon the type of landowner (governmental versus private), the specific property, and the type of green infrastructure improvement. As one example, if the District and a local governmental body want to provide for green infrastructure (such as a rain garden, a collection of trees, a green roof, or a bioswale) within a parking structure or lot, a library or administrative building, a park, or another discrete, fee-owned parcel, then a recorded conservation easement might be more appropriate. But if the District and the governmental body want to provide for a program of green infrastructure (such as porous pavement) within a system or network of streets, alleys, or sidewalks—where the governmental body might hold only rights-of-way, or an undetermined combination of fee-owned property and rights-of-way, and where it is highly unlikely that the governmental body's interest would ever be conveyed to a subsequent purchaser—then a memorandum of understanding or other written instrument, whose agreements are stated to be covenants running with the land in respect of the governmental body's interest, might be more appropriate.

In either case, and as discussed in section 2.5 of this memorandum, the Commission would make findings and determinations that the property interests embodied by the conservation easement or covenants running with the land (along with any green infrastructure improvements on real property owned by the District, to the extent applicable in specific cases) are part of the District's facilities for the collection, transportation, storage, pumping, treatment, and final disposition of sewage.

As a drafting matter, we note that as long as other elements in the written instrument make clear that it constitutes a conservation easement or covenants

running with the land, the specific title of the instrument is not material. *See, e.g., Mnuk v. Harmony Homes, Inc.*, 790 N.W.2d 514, 519 (Wis. Ct. App. 2010) (if the granting clauses make clear that an instrument is an easement, then the title of the instrument, and the fact that it is signed by both parties, does not transform the instrument from a property interest, subject to a 40-year statute of limitations, to a contract, subject to a 6-year statute of limitations), together with additional opinions cited therein.

***Additional alternative: Lien or security interest.*** As yet another alternative, the instrument between the District and a landowner could provide that the landowner's obligations are secured by a lien or security interest in the infrastructure improvements. As with easements and covenants running with the land, liens and security interests on land are an "interest in property" under section 840.01, and thus a reasonable basis exists for a position that the District would be acquiring or purchasing a property interest in specific green infrastructure. We note, however, that it may be more difficult for a landowner to grant a lien or security interest than to grant a conservation easement or covenants running with the land; for example, a lien or security interest by a governmental body may raise constitutional debt concerns, and a lien or security interest by a private landowner may raise issues under its mortgage (whether the mortgage is granted prior to or after the District's lien or security interest).

### **3.5. Additional Considerations: Landowner Title and Power**

As with the acquisition of any property interest, the District will want to confirm that the landowner has sufficient title, and sufficient legal power (under applicable statutes and other law, and under other agreements and obligations of the landowner), to grant the conservation easement or covenants running with the land. We will discuss a few of these considerations briefly, although our discussion is not a comprehensive list or analysis of all considerations that may be relevant.

We note also that the scope of the District's analysis, as well as the actions it pursues to protect its interest, will be determined on a case-by-case basis, based on factors such as the type (governmental or private) and identity of the landowner; the type of real property to be affected by the green infrastructure practice or improvement (a discrete parcel, versus a system or network of streets, alleys, or sidewalks); the amount of the payments to be made to the landowner; and the type, scale, cost, and duration of the specific green infrastructure practice or improvement.

**Landowner title: Fee, leasehold, or easement.** As a background matter, a conservation easement or set of covenants may be given not only by a fee owner, but also by the owner of a leasehold interest (that is, a lessee or tenant) or an easement interest in land. In fact, section 700.40 provides that a conservation easement can impose “affirmative obligations upon the **owner of any interest** in the burdened property”. Wis. Stat. § 700.40 (4) (e) (emphasis added). (Similarly, our use the term “landowner” or “owner” in this memorandum is not limited to the fee owner, but should be read to include the owner of a leasehold or easement interest as well.)

In each case, a landowner can only bind the interest that it holds; for example, the owner of a leasehold or easement interest cannot bind the underlying fee interest (unless the fee owner is also a party to the instrument), and the owner of a fee interest subject to a mortgage cannot bind the mortgage interest (unless the mortgagee is also a party to the instrument). In each case as well, a conservation easement or set of covenants would be subject to the scope, conditions, provisions, and limitations of the landowner’s interest; the limitations would include the duration of the interest, as well as the permitted uses and purposes of the interest. To give an oversimplified illustration, if a landowner held an easement that was limited to *pedestrian* ingress and egress, then the landowner could not grant a conservation easement for the use of porous pavement for *vehicular* ingress and egress.

**Public streets, alleys, and other features.** One type of property for which these background matters are relevant is public streets. In the case of a public street maintained by a local government, the District might consider whether the governmental body holds a fee interest in the street, or it holds only an easement. Under Wisconsin law, “[i]n the absence of a statute expressly providing for the acquisition of the fee, or of a deed from the owner expressly conveying the fee, . . . [the governmental body] acquires merely an easement of passage, the fee title remaining in the landowners.” *Berger v. Town of New Denmark*, 810 N.W.2d 833, 836 (Wis. Ct. App. 2012), quoting *Walker v. Green Lake Cnty.*, 69 N.W.2d 252, 257 (Wis. 1955) (emphasis and additional citations omitted).

Even if the governmental body holds the fee, it may still be circumscribed by statute or other law. For example, in the case of a public street, alley, or other feature dedicated by subdivision plat under chapter 236 of the Wisconsin Statutes, “the land intended for the streets, alleys, ways, commons or other public uses as designated on said plat shall be held by the town, city or village in which such plat is situated **in trust** to and for such uses and purposes.” Wis. Stat. § 236.29 (1) (emphasis added).

Before making any significant investment in a specific green infrastructure program involving public streets, alleys, or other features, the District may want to have a clear understanding with each applicable governmental body that the specific green infrastructure is consistent with the governmental body's interest.

***Private landowners and mortgagees.*** In many cases, and especially with private landowners, a landowner will have given a mortgage on the property at a point in time before granting a conservation easement or covenants running with the land to the District. In such cases the mortgage would have "priority" over the conservation easement or covenants (meaning that the mortgagee could eliminate the District's conservation easement or covenants if the mortgagee foreclosed on the mortgage following a landowner default), and in some cases, the mortgage might prohibit the landowner from granting interests in the property (such as the conservation easement or the covenants) without the mortgagee's consent. Section 700.40 (2) (d), for example, makes clear that the District would take its conservation easement subject to any pre-existing mortgage liens or other pre-existing interests in the property.

Accordingly, in cases where the District's investment in specific green infrastructure would warrant—for example, where the payments to the landowner are significant, the infrastructure improvement has a long useful life or significant public-relations or other value, or there is reason for concern that the landowner might default on its mortgage—the District might consider obtaining (i) a title insurance commitment (or other appropriate title evidence) from a title company to determine what prior mortgages or other encumbrances may affect the property, and (ii) appropriate agreements from mortgagees or other encumbrance holders (such as consents, partial releases, subordination agreements, or non-disturbance agreements), to protect the District's conservation easement or covenants in the event of a landowner's default under the mortgage or other encumbrance.

***Title insurance coverage for conservation easements.*** Similarly, in cases where the District's investment would warrant—for example, where the payments to the landowner are significant, the infrastructure improvement has a long useful life or significant public-relations or other value, or there is reason to believe that the landowner's property might be conveyed to one or more subsequent owners—the District might consider obtaining a title insurance policy insuring its conservation easement. (Typically, a title policy would not be available for a set of covenants; in any event, a title policy would require that an instrument be recorded.) A title policy would provide coverage to the District over various risks, including the risks that the District does not hold a valid easement interest in the property and that there are no prior mortgages or other

encumbrances not identified by the title company. If prior mortgages and encumbrances are identified by the title company, then the District can pursue appropriate consents or other agreements to address them. The costs of title insurance might qualify as capital costs, as additional “cost[s] of acquiring, purchasing, adding to, . . . constructing, extending and improving . . . part of a sewerage system” as contemplated by section 200.21 (1) and as discussed in section 2.3 of this memorandum, although we have not analyzed that point specifically.

### **3.6. Additional Considerations: Public Streets and Alleys**

We note briefly that the District may be able to achieve some of its objectives in public streets and alleys *without* making payments to landowners or acquiring interests in real property. Section 200.35 (7) of the Wisconsin Statutes gives the District the power to “excavate in or otherwise alter any state, county or municipal street, road, alley or public highway in the [D]istrict for the purpose of constructing, maintaining and operating the sewerage system or to construct in the street, road, alley or public highway an interceptor or district sewer or any appurtenance thereof, without providing a bond.” A few procedures are required by the statute: notice by the Commission to the other governmental body; preparation and implementation of a traffic control plan (at Commission expense); and restoration of the street, road, alley or highway following the District’s work (also at Commission expense).

It seems reasonable to interpret the statute as authorizing work by the District anywhere in the street, road, alley or highway *right-of-way* (as opposed to the confines of the street, road, alley, or highway), although the statute is not express on that point. As a practical matter, the District may want to enter into a memorandum of understanding or other agreement with the governmental body, to make sure that the scope and location of the District’s work (among other points) are acceptable to both parties.

We note that section 200.35 (7) does not require any payment by the District to the governmental body for the right to undertake the work (other than in connection with the traffic control plan and restoration of the street, road, alley, or highway). If the District wanted to make such a payment anyway, then the District would still have to acquire an interest in real property in exchange for the payment; that is, section 200.35 (7) does not itself create a property interest, and it would not otherwise make the payment a “capital cost”. (Again, the statute authorizes the work without having to make the payment in the first instance.)

### **3.7. Additional Considerations: Tax Benefits to Landowners**

We note briefly that there may be state or federal tax benefits to a private landowner for granting a conservation easement. For example, for Wisconsin property tax purposes an assessor is required to consider the effect on the value of the property of a conservation easement under section 700.40. Wis. Stat. § 70.32 (1g). (Section 70.32 (1g) does not require consideration of covenants running with the land.) If a perpetual conservation easement is donated, its value might be deductible for state or federal income tax purposes. We have not explored this topic in any detail, but please let us know if you would like us to do so.

### **4. Power to Issue Borrowing Obligations**

The District has the power to finance the costs of green infrastructure with borrowing obligations, certainly with general obligation promissory notes or revenue obligations and, to the extent the payments are capital costs for statutory purposes, with general obligation bonds.

#### **4.1. Public Purpose Doctrine**

Although there is no specific clause in the state constitution establishing the public purpose doctrine, Wisconsin courts accept as a basic constitutional tenet that public funds can only be used for public purposes. *Libertarian Party v. Thompson*, 199 Wis. 2d 790 (1996). The Wisconsin Supreme Court has considered several cases in which a private entity benefits from a public expenditure and concluded that the fact that a private entity will benefit does not destroy a predominant public purpose. *Id.*; *State ex rel. Wisconsin Dev. Authority v. Dammann*, 228 Wis. 147 (1938); *State ex rel. Warren v. Reuter*, 44 Wis. 2d 201 (1969); *State ex rel. Hammertmill v. La Plante*, 58 Wis. 2d 32 (1973). Similarly, with regard to green infrastructure, the improvement to private property should not destroy the predominant public purpose of functioning as part of the District's sewerage system. In this respect, the District's acquisition of a property right in green infrastructure is helpful, even if not essential, because the property right embodies the public benefit and clarifies the distinction between the predominant public purpose and any incidental private benefit.

#### **4.2. Different Types of Borrowing Obligations**

As long as the payments to landowners are within the power of the District to make, the District has the power to issue general obligation promissory notes for the costs of those payments. The applicable statute provides, "Any municipality may issue promissory notes as evidence of indebtedness for any public purpose,

as defined in s. 67.04 (1) (b), including but not limited to paying any general and current municipal expense . . .” Wis. Stat. § 67.12 (12) (a). The District is included within the definition of the term “municipality”, and the term “public purpose” is defined to mean the performance of any power or duty of the issuing municipality, Wis. Stat. §§ 67.01 (5), 67.04 (1) (b), and is informed by the constitutional public purpose doctrine.

The District also has power to issue revenue obligations for costs of payments to landowners. The authorizing statute provides, “All moneys received from [revenue obligations] shall be applied solely for purchasing, acquiring, leasing, constructing, extending, adding to, improving, conducting, controlling, operating or managing a public utility, and in the payment of the cost of subsequent necessary additions, improvements and extensions.” Wis. Stat. § 66.0621 (4) (b) In this statutory description, the gerunds are not limited to capital costs but include operating expenses (“conducting, controlling, operating, or managing”). Thus, the statutory description is sufficiently broad to permit the District to issue revenue obligations for payments to landowners for green infrastructure regardless of whether those costs are treated as capital costs.

By comparison, the District has the power to issue general obligation bonds for costs of payments to landowners, in general, only to the extent it thereby acquires property.

The applicable statute provides that a municipality may issue general obligation bonds “to finance any project undertaken for a public purpose.” Wis. Stat. § 67.04 (2) (a). The term “project” is defined to mean “the acquisition, leasing, planning, design, construction, development, extension, enlargement, renovation, rebuilding, repair or improvement of land, waters, property, highways, buildings, equipment or facilities.” Wis. Stat. § 67.04 (1) (ar). A provision applicable exclusively to the District may expand the scope of bond issuance modestly. It provides, “The purposes for which the commission may issue bonds or notes shall be construed to include financing the cost of planning and designing any part of the sewerage system and the cost of issuing the bonds or notes.” Wis. Stat. § 200.55 (2).

An argument can be made that green infrastructure falls within the definition of the term “project”. Green infrastructure arguably acts to “improve waters” by way of improving the quality or condition of water even in the absence of physical structures, such as treatment facilities. An opinion of the attorney general of Wisconsin urges that interpretation of a provision in the Wisconsin constitution that contains language similar to the language found in section 67.04. *See* Wis. Stat. 67.04 (1) (ar); Wis. Const. art VIII, § 7; 81 Op. Att’y Gen. 114, 118 (1994)

(“Although there is a requirement that any such undertaking clearly improves the quality or condition of the . . . waters, there is no imperative that physical structures be involved.”) As the opinion of the attorney general is only persuasive authority, that argument would be open to the challenge that the provision is limited to improvements by way of physical structures. Similarly, an argument can be made that payments to landowners result in improvements to property, but that argument would be open to challenge that the provision is implicitly limited to property owned by the District.

Because investors in municipal securities customarily require an unqualified legal opinion concerning validity, the District should not use an ambiguous statutory authorization for any borrowing. As a practical matter, the District should issue general obligation promissory notes for green infrastructure, because the authority to issue them is plain.

#### **4.3. Limits on Term of Borrowing Obligations**

Depending on the type of borrowing obligation, the maximum permitted original term varies, but the term allowed for general obligation promissory notes should fit within the District’s borrowing program.

An applicable exception allows the District to issue general obligation promissory notes with an original term not exceeding 20 years. In general, a note must be repaid within 10 years after its original date (and any refunding note must be paid within 20 years of the date of the original note), but the original term may be longer for notes issued for certain purposes. An exception provides that notes “issued to raise funds to pay a portion of the capital costs of a metropolitan sewerage district” must be repaid within 20 years after the original date. Wis. Stat. §§ 67.12 (12) (a), (c) 2.

An exception also applies that allows the District to issue general obligation bonds with a longer maturity. In general, general obligation bonds must be paid within 20 years after the date of issuance; however, a 50-year limit applies to bonds issued by a sewerage district. Wis. Stat. § 67.07.

As with the other types of borrowing, an exception also applies to the District’s revenue obligations. In general, revenue obligations must be paid within 40 years after the date of issuance, Wis. Stat. § 66.0621 (4) (a) 1; however, the District’s revenue obligations must be paid within 50 years. Wis. Stat. § 200.55 (1) (d) 3.

Thus, the maximum permitted original term is 20 years for general obligation promissory notes and 50 years for either general obligation bonds or revenue obligations, when issued by the District for its sewerage system. Even though

general obligation bonds or revenue obligations could be repaid over a longer period of time, the issuance of general obligation promissory notes for green infrastructure should fit well within the District's borrowing program, because the District's borrowing program has been based solely upon the issuance of general obligations that are repaid within 20 years.

## **5. Recent Statutory Amendment Affecting Clean Water Fund Loans**

The District's borrowing program extensively uses clean water fund loans. A recent amendment to state law allows clean water fund loans to be made for the "prevention" of nonpoint source pollution or urban stormwater runoff. 2013 Wisconsin Act 7, enacted March 13, 2013 and effective March 27, 2013. Based on this amendment, clean water fund loans could lawfully be made for green infrastructure. Although the clean water fund program allows participating local governmental borrowers to evidence the repayment obligation with either general obligations or revenue obligations, the practice of the District is to issue general obligation promissory notes to evidence its obligation to repay clean water fund loans.

## **6. Federal Tax Law Matters**

A question related to the District's issuance of borrowing obligations for costs of green infrastructure is whether interest on the obligations may be excluded from gross income for federal income tax purposes. The following discussion sets forth the general framework for determining whether payments to landowners for green infrastructure features may be financed with tax-exempt obligations (which, for simplicity, will be called "bonds" in this discussion).

### **6.1. Some Benefits to Private Users Do Not Create Private Business Use**

The use of bond proceeds to acquire interests that are recognized as distinct property interests for state law purposes—such as conservation easements or covenants running with the land—should be respected for purposes of the federal income tax requirements for tax-exempt bonds.

The IRS has held in a private letter ruling that use of tax-exempt bond proceeds to purchase a conservation easement did not give rise to private business use, even if the property subject to the easement was otherwise used for a private business use. Similarly, the IRS determined in the same private letter ruling that private business use did not arise from the use of tax-exempt bond proceeds to purchase a present fee simple interest in property subject to a *profit à prendre* interest (a right of taking, recognized for state law purposes, that permits the holder to enter the

land of another and remove physical substances, such as timber, minerals, gravel, or game). In the same private letter ruling, however, the IRS held that use of property to purchase a fee simple interest in property subject to a lease with a private user did give rise to private business use. PLR 200502012 (January 14, 2005). This private letter ruling indicates that the form of property interests for state law purposes significantly affects the tax analysis. In general, the private business use analysis will be easier to address if the District acquires separate property interests.

We note, however, that the analysis of whether a contract with a private business user for the use of a separate property interest owned by the District gives rise to private business use may need to take into account any related property interests held by the private business user.

One particularly important Tax Court decision may provide a basis to determine that certain types of expenditures do not give rise to private business use. *City of Santa Rosa v. Commissioner*, 120 T.C. 339 (2003). The case concerned the use of tax-exempt bond proceeds by a city operating a sewer system to reduce wastewater. The city proposed to issue bonds to finance a sewerage wastewater pipeline to reduce its wastewater discharges. The wastewater was to be used by a private utility company as part of a process to generate electricity from geysers. The utility company agreed to accept the wastewater but made no payments to the city. The IRS asserted that this resulted in private business use of the bond proceeds. The court rejected the IRS position and held that the pipeline was not used for a private business use. There is some uncertainty regarding how far the holding in this decision extends to other types of projects, but the holding may provide a basis to determine that certain types of projects do not give rise to private business use, even though the projects have benefits to private users.

## **6.2. Considerations as to Term of Borrowing**

Limitations on the term of the bond financing may need to be considered for expenditures that are not treated as capital expenditures having a long economic life—either because the economic life is short (for example, an interest in property that has a short term) or because the expenditure is not treated as a capital expenditure (for example, no interest in property is acquired).

The tax-exempt bond regulations do not directly require that the term of a bond issue match the economic life of the financed property. The tax-exempt bond regulations do, however, contain a rule that provides that a bond issue with a term “longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds” can be an abusive transaction. Treas. Reg. §1.148-10(a)(4). Particularly in the case of use of proceeds for expenditures that may not be treated as capital expenditures for federal income tax purposes, the

District will need to carefully consider whether the term of the bond issue meets this standard.

### **6.3. Effect on Private Activity Bond Tests**

To issue tax-exempt bonds for green infrastructure, the District may need to comply with the private business use test rather than relying on the security or payment test.

In general, a governmental bond issue is treated as a private activity bond (not tax-exempt) only if the bond issue has more than the permitted amount of “private business use” *and* more than the permitted amount of private “security or payments.” The permitted limit for both purposes are generally 10%, but are 5% if the use is “unrelated” or “disproportionate”. In the case of many general obligation bond issues, the amount of private business use may not be an essential concern, because it may be clear that the amount of private security or payments is less than the permitted limits, even if the amount of private business use is much greater. For example, a state may issue general obligation bonds and use the proceeds to make a grant to construct a project that will be leased to private persons; so long as the state does not receive any lease payments, the bond issue will not meet the private security or payment test.

In the case of an issuer that is an enterprise system imposing user fees, the application of the private payment test is not as clear. The IRS has taken the view that user fees (as contrasted with taxes of general application) generally are treated as private payments. For example, suppose the District issues bonds to make a grant to a private corporation to build structures that reduce runoff. It is possible that the IRS would take the view that a portion of the user fees paid by users of the system are associated with that grant. On the other hand, IRS regulations indicate that some types of payments to private persons that further a governmental purpose, such as the undergrounding of utilities, generally do not need to be treated as private payments.

For the District, the private payment analysis is potentially particularly complex, because its sources of revenues are in part taxes of general application and in part user fees.

For the foregoing reasons, the most straightforward approach to tax-exempt bond compliance would be for each bond issue to comply with the private business use test (that is, not permit more than 10%, or in some cases 5%, of the bond proceeds to be used for private business use). An alternative analysis relying on private payments may be possible in some cases but in general is likely to present more complex tax issues.

#### **6.4. Prepayment Considerations**

IRS regulations generally restrict the use of tax-exempt bonds to make prepayments for property or services that are not customary. *See* Treas. Reg. § 1.148-1(e)(2). For example, tax-exempt bond financing of prepayments of lease rental payments is not usually permitted. Tax-exempt bond financing of certain types of property may need to be evaluated under this rule.

#### **6.5. Favorable Treatment of Grants**

Certain green infrastructure expenditures not treated as capital expenditures can be financed with tax-exempt bonds only if they take the form of grants.

The federal income tax rules for tax-exempt bonds restrict the use of bond proceeds to finance expenditures that are not capital expenditures. The IRS has ruled that certain “demand side” expenditures of public utilities are not properly treated as capital expenditures for federal income tax purposes (but are instead deductible). *See, e.g.,* Rev. Rul. 95-32, Treas. Reg. 1.263(a)-1T. The “proceeds-spent-last” rule for working capital expenditures that is set forth in the tax-exempt bond regulations, however, has an exception for governmental grants, as is set forth above. Accordingly, use of tax-exempt bond proceeds for certain green infrastructure expenditures that cannot be treated as capital expenditures may be permitted only if the expenditures take the form of governmental grants.

#### **6.6. Grants Should Not Be in Substance Loans**

Amounts that are in form grants generally should be structured so that they are not in substance loans.

The Internal Revenue Code generally permits the use of tax-exempt “governmental” bonds to finance grants that fulfill governmental purposes. Section 141(c) of the Code, however, generally provides that no more than the lesser of 5 percent of the proceeds of a bond issue, or \$5 million, may be used to finance loans (an exception for certain “tax assessment loans” would not apply unless Wis. Stat. § 66.0627, the statute authorizing so-called PACE bonds—standing for “property assessed clean energy” bonds—were appropriately amended and the District issued bonds under that statute).

The federal income tax regulations concerning tax-exempt bonds set forth the following definition of the term “grant”:

*Grant* means a transfer for a governmental purpose of money or property to a transferee that is not a

related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

Treas. Reg. §1.148-6(d)(4)(iii). Thus, any requirements of the grantee to repay the grant must be carefully evaluated to determine that an expenditure in the form of a grant is not in substance a loan for federal income tax purposes.

### **CONCLUSION**

Thus, we conclude that a basis exists for the District to treat the costs for specific practices or improvements as capital costs for statutory purposes. For the District to do so, the transactions should be structured so that the District acquires interests in real property—which can be done using conservation easements or covenants running with the land. In addition, the Commission should make reasonably supported legislative findings and determinations to establish that the property interests acquired are used as part of the District's sewerage system.

The District has the power to finance the costs with general obligation promissory notes or revenue obligations and, so long as the payments are capital costs for statutory purposes, also has the power to finance the costs with general obligation bonds. As a practical matter, however, general obligation promissory notes should be issued. Also, whether interest on the borrowing obligations may be excluded from gross income for federal income tax purposes will depend on several factors.

EXHIBIT A

COMMISSION FILE NO. 12-106-7

[Attached]



**COMMISSION FILE NO:** 12-106-7 **DATE INTRODUCED:** July 9, 2012

**INTRODUCED BY:** Executive Director Signature on File in the Office of the Commission

**REFERRED BY COMMISSION CHAIRPERSON TO:** Policy, Finance, and Personnel Committee

**RELATING TO:** Approval of Commission Policy "MMSD Infrastructure Includes Green Infrastructure"

**SUMMARY:**

The Commission is requested to approve the attached Commission Policy 1-11.05, "MMSD Infrastructure Includes Green Infrastructure". The policy describes the District's commitments to enhance the capacity and operation of the District's system through the construction of green infrastructure strategies. It also describes the District's commitments to act as an environmental steward for the Greater Milwaukee Watersheds through the pursuit and establishment of policies, programs, and practices that are focused on the widespread implementation of green infrastructure. This is related to and expands on Commission Policy 1-11.4, "Environmental Sustainability" and the "2035 Vision and Strategic Objectives" approved January 2011.

**ATTACHMENTS:** BACKGROUND  KEY ISSUES  RESOLUTION   
FISCAL NOTE  S/W/MBE  OTHER  Commission Policy 1-11.05

*PFPP\_Green\_Infrastructure\_Commission\_Policy\_Legislative\_file.doc  
06-25-12*

**COMMITTEE ACTION:** \_\_\_\_\_ **DATE:** \_\_\_\_\_

**COMMISSION ACTION:** \_\_\_\_\_ **DATE:** \_\_\_\_\_

## BACKGROUND

### Approval of Commission Policy "MMSD Infrastructure Includes Green Infrastructure"

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By approving the Commission Policy on Environmental Sustainability in 2005, the Commission sent a strong message that the District will act as an environmental steward for the Greater Milwaukee Watersheds. Policy approval ensured that the District will continue to sustainably meet capacity and infrastructure needs for the control of pollution through the services and processes it provides. Those services include the collection, conveyance, storage, and treatment of wastewater from combined and separate municipal systems. Those services also include the management of out-of-bank flooding.

By approving the 2035 Vision and Strategic Objectives in 2011, the Commission expanded on this message. For instance, the 2035 Vision identifies integrated watershed management as a strategic objective. Integrated watershed management includes the use of green infrastructure to reduce stress on MMSD's existing infrastructure system and restore a more natural hydrology to the region's landscape.

Commission Policy 1-11.05, "MMSD Infrastructure Includes Green Infrastructure", sets forth a new policy to allow for MMSD capacity and infrastructure needs be augmented in a distributed, "green" fashion throughout the region where stormwater and snow falls on the land. Stormwater runoff and snow melt naturally flows downhill and seeks its lowest point. That lowest point often is the MMSD collection system or watercourses under MMSD jurisdiction. The future ability to address stormwater where it falls, through a natural or natural-like system known as green infrastructure, will provide MMSD with additional tools to reduce volumes and control pollution as follows:

- **Infiltration:** the ability to hold water where it falls on the land and to be used by plants.
- **Evapotranspiration:** the release of water back into the atmosphere through plants leaves.
- **Capture for reuse:** storage of stormwater that would normally go into the storm sewer or area waterways and holding it in rain barrels, cisterns or similar water capture systems for later reuse.

The benefits of the implementation of widespread green infrastructure to the operation of MMSD's system vary by location in the separate versus the combined area as follows:

**MMSD Collection System, Separate Sewer Service Area (SSSA):** In the SSSA, green infrastructure provides both water quantity and water quality benefits.

## BACKGROUND (Cont'd)

### Approval of Commission Policy "MMSD Infrastructure Includes Green Infrastructure"

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- **SSSA Water Quantity:** With proper placement, green infrastructure can hold, evapotranspire, and infiltrate into the soil stormwater that can otherwise leak or illicitly connect into sanitary sewers. Where this happens, green infrastructure can reduce the amount of wet weather flows treated at water reclamation facilities and, in turn, reduce the energy requirements for that treatment. Proper placement of green infrastructure measures also supports current programs, such as the Private Property Inflow and Infiltration Program, to help keep excess water from making its way into broken or cracked sewer pipes.
- **SSSA Water Quality:** Green infrastructure can reduce the volume of stormwater runoff that picks up pollutants from lawns, parking lots, and roads and, in turn, the amount of pollutants that end up in area waterways. In addition, green infrastructure buffers along waterways can filter polluted stormwater runoff.

**MMSD Collection System, Combined Sewer Service Area (CSSA):** In the CSSA, green infrastructure provides both water quantity and water quality benefits (although in different ways than in the SSSA).

- **CSSA Water Quantity:** With proper placement, green infrastructure can hold, evapotranspire, and infiltrate into the soil stormwater that by design connects into combined sewers. This can reduce the amount of combined wet weather flows treated at the water reclamation facilities and, in turn, the energy requirements to reclaim water. Green infrastructure can also reduce the volume of combined sewer overflows that happen on occasion during significant storms.
- **CSSA Water Quality:** For riparian areas of the CSSA plumbed directly to area waterways, green infrastructure buffers along waterways can filter polluted stormwater runoff that would otherwise flow untreated to area waterways.

**MMSD Jurisdictional Watercourses:** Where MMSD manages out-of-bank flooding, green infrastructure may hold, evapotranspire, and infiltrate into the soil stormwater that could enter waterways via grey infrastructure and subsequently contribute to downstream flooding. With widespread implementation, there may be cases where green infrastructure can reduce the size of needed flood management practices.

Additional benefits for MMSD may include greenhouse gas emission reductions, water footprint reductions, and infrastructure cost savings. In addition, climate change predictions for the Midwest indicate more frequent severe storms in the years to come. Green infrastructure can supplement the ability of grey infrastructure in the Greater Milwaukee Watersheds to handle some of this stormwater.

## **RESOLUTION**

Approval of Commission Policy "MMSD Infrastructure Includes Green Infrastructure"

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**RESOLVED**, by the Milwaukee Metropolitan Sewerage Commission, that Commission Policy 1-11.05, "MMSD Infrastructure Includes Green Infrastructure", is hereby approved.



# Commission Policy

<b>Subject:</b> MMSD Infrastructure Includes Green Infrastructure	<b>Index:</b> 1-11.05  <b>Page:</b> 1 of 2
<b>Authority Statute:</b>  <b>Resolution:</b>	<b>Date Issued:</b> 07/23/12  <b>Date Revised:</b>

The Milwaukee Metropolitan Sewerage District (MMSD) is committed to meeting its water pollution control responsibilities for wastewater it collects, conveys, stores, and reclaims and watercourses it manages to mitigate out-of-bank flooding. In seeking its lowest point of discharge, stormwater runoff most often currently drains to the MMSD system or watercourses under MMSD jurisdiction. Widespread implementation of green infrastructure is intended to change that consequence of runoff negatively impacting MMSD’s systems. Green infrastructure can provide additional capacity by allowing collection, conveyance, and storage solutions earlier (higher up) in the hydrologic cycle, where stormwater and snow falls on the land.

MMSD is committed to meeting conditions of its current and future Wisconsin Pollutant Discharge Elimination System (WPDES) permit. In the future, that permit will likely include provisions related to green infrastructure planning and more widespread implementation projects. This policy is consistent with current and likely future WPDES permit conditions.

For purposes of this policy and as per the US Environmental Protection Agency (EPA), green infrastructure is defined as an approach to wet weather management that is cost-effective, sustainable, and environmentally friendly. It helps restore natural hydrology and also provides additional non-stormwater benefits as well. Examples include (but are not limited to) green roofs, rain barrels, rain gardens, pavement infiltration in parking lots and roadways, green parking lots and streets, trees, and rainwater harvesting for non-potable uses. At its best, green infrastructure incorporates many of these examples in a “train” or system.

Specifically at MMSD, green infrastructure strategies include these:

- **Greenways:** riparian and non-riparian buffer zones and strips that store and drain stormwater runoff into the ground naturally.
- **Rain Gardens:** gardens that are watered by collected or pooled stormwater runoff, slowly infiltrating it into the ground along root pathways.
- **Wetlands:** areas that have soils that are inundated or saturated for part of the year or the entire year.
- **Trees:** trees that can hold rainwater on their leaves and branches, infiltrate it into the ground, absorb it through root systems, and evapotranspire it to the atmosphere.



# Commission Policy

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- **Green Roofs:** partially or completely planted roofs with vegetation growing in soil or other growing media to hold rainwater.
- **Bioswales:** landscape features that capture and infiltrate runoff and can also remove its pollutants.
- **Porous Pavement:** pavement that can reduce and infiltrate surface runoff through its permeable surface into a stone or filter media below.
- **Native Landscaping:** the use of native plants that can tolerate drought and flooding cycles because of deep roots and climate-specific adaptations.
- **Rainwater Catchment:** the capture and storage of water, potentially for reuse later.
- **Green Alleys, Streets, and Parking Lots:** public infrastructure features that can channel, infiltrate, and evapotranspire water.

Greenseams<sup>®</sup> is also considered green infrastructure because it preserves and protects key lands with hydric soils and buffer waterways. Further, green infrastructure is a tool to supplement traditional grey infrastructure that makes up modern day wastewater collection systems.

**Commitment:**

1. MMSD will encourage the use of green infrastructure where various benefits may be provided, particularly overlapping benefits related to environmental, social, and economic sustainability.
2. MMSD will continue to support programs of information and education related to green infrastructure.
3. MMSD will annually report to the Commission the progress of its green infrastructure efforts and the benefits that result.
4. MMSD will consider, pioneer, and make widespread, as appropriate, green infrastructure technologies that benefit the existing MMSD system of grey infrastructure.
5. MMSD will work to attain the green infrastructure goals of the 2035 Vision.
6. MMSD will coordinate with other groups in the region to provide support for more widespread green infrastructure implementation.