



New York State Legislature Considering Imposition of Mortgage Recording Tax on Mezzanine Loans and Preferred Equity



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In January of this year a **bill** was proposed in the New York State legislature that would impose mortgage recording tax on mezzanine loans. The bill was recently amended to clarify that mortgage recording tax would also be imposed on preferred equity investments. In addition, in connection with either a mezzanine loan or a preferred equity investment, the mezzanine lender or preferred equity holder, as applicable, would be required to file a UCC-1 Financing Statement in the real property records to perfect its security interest in its collateral – certain membership interests or shares in the mortgage borrower.

The bill defines “mezzanine debt” and “preferred equity investments” as “debt carried by a borrower that may be subordinate to the primary lien and is senior to the common shares of an entity or the borrower’s equity and reported as assets for the purposes of financing such primary lien. This shall include non-traditional financing techniques such as a direct or indirect investment by a financing source in an entity that owns the [equity] interests of the underlying mortgage where the financing source has special rights or preferred rights such as: (i) the right to receive a special or preferred rate of return on its capital investment; and (ii) the right to an accelerated repayment of the investor[’]s capital contribution.” This bill may prove to be problematic for any joint venture that does not have a *pari passu* waterfall for distributions.

The bill specifically states that the same does not apply to a loan secured by cooperative shares in a cooperative apartment.

The purpose of the bill is (1) to raise additional tax money in the State of New York to fund capital expenditures related to public housing and (2) to require the disclosure of mezzanine loans and preferred equity in the public record so that a third party has a more accurate view of the debt stack with respect to a piece of real property.

The mortgage recording tax in New York City on commercial debt in excess of \$500,000 is 2.80% of the principal amount of the debt. To the extent that the proposed legislation is signed into law, the same will have a significant impact on

the financing of large real estate projects in the State of New York, and we expect that, just as sophisticated real estate players have become savvy at assigning mortgage debt to save mortgage recording tax and structuring deals to limit the imposition of mortgage recording tax, they will do the same to the extent that mortgage recording tax is imposed on mezzanine loans and preferred equity investments.