

New York State is Considering a (New) Tax That Would Apply to Mezzanine Loans and Preferred Equity

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A New York State legislative proposal (currently in committee review) would impose mortgage recording tax on mezzanine debt and preferred equity investments related to real property upon which a senior loan is being recorded.

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,” and expands the definition by including: “non-traditional financing techniques ... 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 investors capital contribution.” This relatively broad definition of “mezzanine debt and preferred equity investments” may open the door to a wide range of joint venture arrangements being subject to the proposed recording tax, creating recording tax risk for joint ventures with complicated waterfalls and different classes of interests or IRR hurdles. The proposal contains a limited carve-out for owner-occupied residential cooperatives.

Under the proposal, the senior lender will not be able to record its mortgage if the recording tax is not paid on the mezzanine debt or preferred equity. Assignments, releases, and discharges of mortgages will also not be available if the new tax is not paid. Finally, if the proposed recording tax is not paid and a financing statement is not filed, the holders of such mezzanine debt and/or preferred equity investments may not be able to enforce remedies under UCC Article 9, e.g., the right to sell the collateral may not be available upon default of the mortgages. This means that, as a practical matter, it would be difficult for an investor in preferred equity to avoid filing a financing statement and paying the tax.