

February 5, 2020

NY State Legislature Considers Extending Mortgage Recording Tax to Mezzanine Debt

The New York State legislature is considering extending the application of the mortgage recording tax to mezzanine debt financings. The [proposed bill](#) would amend the existing mortgage recording tax provisions to (i) require that any mezzanine debt (debt secured by the equity interests in an entity that owns real property) be recorded concurrently with the related mortgage instrument and (ii) establish that the sum of the mortgage debt and any mezzanine debt be taxable at the applicable New York State mortgage recording tax rate (for commercial mortgages over \$500k, the current rate for properties within NYC is 2.80%; for most counties outside of NYC, the rate is about 1%). All tax revenue generated from mortgages with related mezzanine debt would directly fund the development, maintenance or management of public housing and/or affordable housing.

Passage of the proposed bill would be expected to have a significant impact on the real estate financing market in New York. Parties looking to avoid additional taxes associated with mezzanine debt might look to alternative financing structures, including second lien mortgages or preferred equity, in lieu of traditional mezzanine lending. In such a case, the incremental risk involved in structuring debt as equity, even with conservative terms, has the potential to increase the cost of financing real estate. Such an increased tax burden or related increased costs might also impact the volume of commercial transactions in New York relative to other markets.

As the bill remains in committee stage and has not been vetted through the legislative process, there are a number of technical questions which will need to be addressed for any changes to become operational (for example, the aforementioned loophole for preferred equity created by the currently proposed definition of “mezzanine debt”). We anticipate that interested parties will press on these items with the legislature in the coming weeks and months, and more clarity will be forthcoming with respect to any final resolutions.