COMMERCIAL CREDIT LINE MORTGAGES

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A business is borrowing to fund and perhaps even expand its operations by obtaining a revolving line of credit. The borrower can post as collateral a parcel of real property it owns in New York State. However, mortgage recording tax in New York will have a major impact on the economics of the loan; if the property being mortgaged is in New York City the applicable tax rate is 2.80% when the amount secured is $500,000 or more. Paying mortgage tax on the aggregate amount of money advanced and re-advanced over time under the credit line can therefore be very expensive. As noted in a 1953 Opinion of New York State's Attorney General [FN 1], a re-advance secured by a mortgage represents a new and further indebtedness and is subject to mortgage tax, payable on the recording of a further instrument evidencing the re-advance.

As discussed by this author in a long ago published article [FN 2], the amount of mortgage tax that is due and payable can be limited by securing only a portion of the overall indebtedness. The mortgage can secure only a portion of the loan, on which amount mortgage tax is payable, and include a so-called last dollar provision pursuant to which only the last dollars of the loan to be repaid, below a capped amount on which tax is paid, are secured. [FN 3] Only the unsecured portion of the loan above the cap will revolve and the secured amount becomes, in effect, a term loan.

For example, a line of credit of $20 Million is secured by a mortgage expressly securing a maximum amount of $5 Million, on which amount mortgage tax is paid. With a last dollar clause in the mortgage, so long as the indebtedness outstanding remains above that secured amount the borrower can borrow, repay and obtain re-advances of the loan in excess of the $5 Million, and mortgage tax will have been properly and fully paid on recording on only the amount secured.

The last dollar safe harbor can be useful, particularly when the value of the mortgaged property is less than the full amount of the loan. However, it provides little assistance for smaller commercial revolving credit loans. Accordingly, Subsection 1-a to Tax Law Section 253-b ("Credit line mortgage") was amended effective November 6, 1996 (FN 4) to allow re-advances secured by a mortgage on commercial property (other than property principally improved or to be improved by a one-to-six family owner- occupied residence or dwelling) (FN 5) to be made without the payment of mortgage tax on any re-advances, provided that the mortgage secures less than $3 Million dollars and the advances are not made under a building loan contract.

According to a letter dated July 17, 1996 from the New York State Bankers Association to the Counsel to then Governor Pataki, this legislation was needed because "[u]nder current law, the mortgage recording tax makes it impractical for small businesses to take out lines of credit secured by commercial property. As a result this type of financing has not been readily available in New York State. In other states it has proven to be quite helpful in financing new and expanding business plants and locations". The letter further suggested that by making commercial lines of credit more readily available, substantial additional mortgage tax revenue would be realized.

Similarly, according to a Memorandum of Support accompanying the legislation, the preferential treatment of re-advances secured by commercial credit line mortgages as provided for in the legislation "should enhance the ability of small businesses to address capital" and "the bill should have a positive fiscal impact by encouraging businesses to utilize credit line mortgages, which would generate mortgage tax revenues for localities".

With a need in the present economic environment for New York's small businesses to access capital, and also a need for cash strapped local governments to receive more revenue, it may be appropriate to examine the manner in which the statute has been applied.

The State regulation on credit line mortgages (20 NYCRR 647.1) provides little guidance. However, New York State's Department of Taxation and Finance ("Department") in 1999 issued "Application of the Mortgage Recording Tax to Commercial Credit Line Mortgages" [FN 6]. Also issued in 1999 were an Advisory Opinion [FN7] and a "Declaratory Ruling Relating to Credit Line Mortgages"[FN8]; while they deal specifically with credit line mortgages on one-to-six family dwellings the positions they state will most likely be applied by the Department to commercial revolving credit line mortgages. Further, since 1999, the Department has informally advised this author on a number of related issues.

First, assume that XYZ LLC obtains a revolving line of credit of $2,999,999 secured by a mortgage on its commercial property. This mortgage falls within the safe harbor of Section 253-b. Mortgage tax is paid on a stated maximum amount secured and no mortgage tax is due on the making of any re-advances. If, however, the mortgage secures part of a larger credit line, such as $5,000,000, the mortgage tax safe harbor of Section 253-b will not apply; without a last dollar clause in the mortgage, tax will be payable on each re-advance as it is made, in addition to tax being paid at recording on the amount stated in the mortgage as being secured.

Assume, alternatively, that XYZ LLC's revolving line of credit for $2,999,999 is secured by a mortgage made by its affiliated entity. Since the mortgage is not being made by the obligor, the Department takes the position that Section 253-b does not apply, regardless of the amount secured. A last dollar clause will be necessary to avoid the taxing of each re-advance. Again, the line of credit, to the extent of the amount secured by the guarantor's mortgage, becomes, in effect, a term loan; only the amount of the loan above that secured by the mortgage may revolve. The making of a secured, revolving credit loan in these instances may not be practical.

Similarly, informal advise has been received from the Department that the obligors under a revolving line of credit and the mortgagors of the mortgage securing that credit line need to be the same to obtain the benefits of Section 253-b, except when a husband and his wife execute a mortgage to secure the revolving credit obligations of either one of them.

What if the borrower has a revolving line of credit for $2,999,999 and a term loan with the same lender? According to the Department, if both loans are secured by the same mortgage, the safe harbor of Section 253-b will not apply. If the loans are secured by separate mortgages, whether Section 253-b applies may depend on whether each loan is under a separate loan agreement. If not, and the total of the amounts secured by the mortgages is $3,000,000 or more, the revolving credit mortgage will not obtain the benefits of Section 253-b.

There can be an issue even when the revolving credit and term loans each stem from a separate loan agreement. For example, assume a term loan made in 2002 secured by a mortgage on which mortgage tax was duly paid. In 2011, the same borrower and lender enter into an agreement to fund a revolving line of credit in the amount of $2,999,999 also secured by a mortgage. The credit line mortgage is cross-defaulted with the term loan or recites that it is also given as additional collateral security for the term loan. The credit line mortgage will not receive the benefits of Section 253-b.

What if, instead, a borrower and its lender decide to convert a mortgage securing a term loan having a reduced principal balance of $2,999,999 to a credit line mortgage? According to the Department, a term loan cannot be converted to a credit line mortgage receiving the benefits of Section 253-b. Under that Section, the mortgage must be an eligible credit line mortgage at its inception.

Although the above referenced Advisory Opinion [FN 9] and Declaratory Ruling [FN 10] deal with credit line mortgages on property improved or to be improved by a 1-6 family owner-occupied residence or dwelling, these rulings appear in concept to apply to revolving credit mortgages on commercial property as well. The Advisory Opinion indicates that Section 253-b will not apply to a mortgage when the advances are to reimburse the borrower for expenses incurred in making improvements to real property, even when a Building Loan Agreement has not been filed. Under the Declaratory Ruling, when an extension of the draw period is not provided for in the original mortgage ("explicitly" or by reason of a "change in terms" provision), the recording of an agreement extending the draw period will be treated as evidencing a new or further debt or obligation, and mortgage tax will be payable on recording of that agreement computed on the amount recited as being secured. Accordingly, if the draw period under a $2,999,999 revolving line of credit expires and is then extended, mortgage tax may again be payable on the principal amount secured when the extension agreement is recorded.

Enhancing the ability of small businesses to obtain credit, while at the same time increasing mortgage tax revenue to localities, is more important now than when Section 253-b was amended in 1996 to allow preferential treatment to commercial credit line mortgages securing less than $3 Million. Toward that end, amendments to the statute mandating a more expansive application would be appropriate.

In any event, consideration should be given to increasing Section 253-b's safe harbor for commercial credit line mortgages to mortgages securing substantially more than $3 Million. What might have been a practical amount in 1996 may not, fifteen years later, sufficiently encourage the making of commercial credit line mortgages, which was the reason for the change in the law.

FN1. 1953 Opns. Att. Gen. 198

FN2. Berey, "The Last Dollar Endorsement and Capping a New York Mortgage", New York Law Journal, 10/15/95 N.Y.L.J. 5. The discussion of last-dollar does not apply to the Conditions of the 2006 ALTA Loan Policy.

FN3. See New York State Department of Taxation and Finance Advisory Opinion TSB-A-93(15)R , dated September 3, 1993.

FN4. Chapters 489 and 490 of the Laws of 1996.

FN5. Favorable mortgage tax treatment is afforded property principally improved or to be improved by a one-to-six family owner- occupied residence or dwelling by Subsection 1 of Tax Law Section 253-b. The application of Section 253 discussed in this article also apply to those credit line mortgages.

FN6. TSB-M-99(1)R, June 25, 1999.

FN7. TSB-A-99(2)R, April 7, 1999

FN8. TSB-M-99(3)R, November 10, 1999

FN9. TSB-A-99(2)R, April 7, 1999

FN10. TSB-M-99(3)R, November 10, 1999

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