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A Transfer Tax Can be a Hidden Cost When Purchasing a Real Estate Loan

It may not be obvious, but if you are purchasing a loan (even a mezzanine loan) you need to investigate whether your foreclosure of the loan will trigger a transfer tax and, if so, build the amount of the tax into your budget or into your negotiations with the seller of the loan.

Consider, for example, a situation in which you are buying, say, a \$100,000,000 face amount mortgage loan for 25 cents on the dollar (i.e. you are spending \$25,000,000). The underlying property, however, is worth \$200,000,000 and there is a 2% transfer tax in the applicable jurisdiction that applies on transfers in foreclosure. In this event, your cost of realizing on the collateral could be an extra \$4,000,000 in transfer tax (or 16% more than you budgeted to obtain control of the collateral). This same state of facts could occur (but with an even higher percentage over budget) in a mezzanine loan situation if foreclosure of a mezzanine loan in the applicable jurisdiction triggers a transfer tax payment obligation – i.e., a tax on the transfer of a “controlling interest” triggered by a foreclosure of equity in the property owner.

This Plain & Simple article does not delve into the specifics, as each jurisdiction differs in various ways, including: (i) whether there is a transfer tax at all, (ii) whether it applies in a foreclosure situation, and (iii) of course, the amount of the tax. The point here is that you should investigate both local law and the economics of this issue before binding yourself to purchase a loan.

TARP UPDATE

Secretary Paulson of the Treasury Department issued a statement on November 12, 2008, providing an update on the state of the economy and the development and implementation of the measures being taken under the Troubled Asset Relief Program (“TARP”). The announcement signaled a further movement away from the original emphasis highlighted in the TARP legislation – the purchase of troubled assets and mortgage-backed securities from struggling financial institutions. Treasury has already used the broad language of TARP to create the Capital Purchase Program, through which billions of dollars have been, and continue to be, injected directly into banks. Secretary Paulson’s announcement indicates that TARP funds will continue to be used to capitalize financial institutions, but that there will also be a shift of emphasis towards consumer lending and that, to that end, Treasury is working with the Federal Reserve to develop strategies to bring private investors back into the market for securities backed by credit cards and automobile loans, in addition to mortgages. The Secretary also indicated that Treasury was continuing to look at ways to help prevent foreclosures, although the government is no longer planning on purchasing illiquid mortgage assets as originally contemplated.

Although Secretary Paulson did not rule out the possibility that the government might still purchase assets – he indicated that Treasury was continuing to examine whether targeted forms of asset purchase can play a useful role – this shift of emphasis by the government is quite significant. The language of the TARP legislation is heavily focused on the purchase of assets and the development of procedural controls for those purchases. With these developments, it would appear that in addition to a continuing shift away from asset purchase towards capital injection, it is possible that the government is also moving away from a primary focus on problems centered in real estate and real estate-related securities to the broader economy as a whole.

Distressed Real Estate Practice Group

Duval & Stachenfeld has positioned itself to be ready for the downturn in real estate by acquiring and training knowledgeable and talented lawyers in the critical areas for distressed real estate; namely, **real estate**, **bankruptcy** and **litigation**. In that regard, the Firm has established its Distressed Real Estate Practice Group to provide coordinated expertise in these legal areas and to provide advice and guidance regarding workouts, debt and equity restructurings and recapitalizations, bankruptcies, distressed debt and distressed property acquisitions and dispositions, and related litigation.

If you would like additional information regarding the substance of this Plain & Simple newsletter, please contact one of Duval & Stachenfeld LLP's [Distressed Real Estate Practice Group](#) chairs.

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