

Loans could be getting more expensive

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Let's say you own a company and are obtaining a \$4 million loan. That loan is to be secured by various assets of the company, including real estate. The real estate itself has a value of \$1 million. A new attorney general opinion will make this transaction considerably more expensive for your company.

Previously, you would have paid only \$3,333 to record the deed of trust on the \$4 million loan. That recordation tax will jump four-fold now by \$10,000 to \$13,333. Thankfully, with good upfront planning and communication with your lender, this additional expense may be avoidable.

On May 27, the Virginia attorney general issued an opinion resolving, unfavorably to borrowers, an apparent conflict on how to calculate recordation taxes when the amount secured under the deed of trust is greater than the fair market value of the property. The attorney general concluded that the recordation tax should be based on the amount of the indebtedness rather than the fair market value of the encumbered property.

The Virginia Code provides that the recordation tax on deeds of trust should be based on "the amount of bonds or other obligations secured thereby."

Regulations were issued years ago interpreting this provision to mean that "the amount secured by a recorded deed of trust can never be more than the fair market value of the property described and conveyed by the deed." The regulations even include an example of a deed of trust encumbering a \$30,000 piece of property and securing a \$160,000 note being taxed only on the \$30,000 value of the property.

The attorney general rejected this interpretation. The attorney general concluded that the "secured thereby" language of the code applies to the entire amount of the note without regard to the value of the collateral.

Under the hypothetical situation described above, your company, as the borrower, should confirm with the bank at the commitment letter stage that the bank will only receive a \$1 million deed of trust. The deed of trust should specify that, while the deed of trust secures the \$4 million note, the "maximum amount secured thereby" is \$1 million.

Better yet, your loan could be structured with two notes - a \$1 million real estate note secured by the deed of trust and a \$3 million note secured by other assets of the company (not the real estate). In that scenario, there is no question that the deed of trust secures only \$1 million and that the recordation tax will be based on that amount. This structure has the added benefit of enabling your company to pay off the \$1 million note and have the deed of trust released from the real estate.

The earlier this issue is raised with your lender, the better. It will be easier to persuade the bank to limit its security under the deed of trust while the bank is still trying to woo your company as a customer. The downside to the lender is that its lien on your company's real estate will be limited to the specified amount, in this case \$1 million. If your property appreciates in value - yes, that used to happen, the lender will not benefit from the increased value if there is ever a foreclosure sale.

If you wait until the parties are at the closing table to raise this issue, it will be too late. At that point, the bank will have already underwritten and approved the loan, the loan documents will have been finalized and your company will be counting on its money. At that point, restructuring and redocumenting your loan will eat up a considerable portion of your potential recordation tax savings. These details should be discussed with the lender at the outset and memorialized in the commitment letter.

In a typical real estate loan transaction, the loan amount will be less than the value of the collateral. The above situation occurs when real estate is just one component of the lender's collateral. If you are anticipating a scenario in which your loan will exceed the value of your real estate collateral, be sure to discuss this issue with your attorney and lender early in the process. Otherwise, your settlement statement may produce considerable sticker shock when it comes to recordation taxes.

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