

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-04(1)R
Mortgage Recording Tax
April 28, 2004

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M040209A

On February 10, 2004, the Department of Taxation and Finance received a Petition for Advisory Opinion from Fort Hamilton Housing LLC, c/o Richard R. Upton, Esq., Patterson, Belknap, Webb, & Tyler LLP, 1133 Avenue of the Americas, New York, NY 10036-6710.

The issue raised by Petitioner, Fort Hamilton Housing LLC, is whether the taxes imposed by Article 11 of the Tax Law (the "mortgage recording tax") will be due upon the recording of any mortgage on certain leasehold interests, described below, provided that (a) the proceeds of the mortgage are used by Petitioner for the rehabilitation and reconstruction of military housing units located at Fort Hamilton Military Base and (b) the United States Army executes and records the mortgage on behalf of itself (as lessee under the sublease and lessor under the sub-sublease), and Petitioner (as lessee, sublessor, and sub-sublessee, as discussed below).

Petitioner submits the following facts as the basis for this Advisory Opinion.

Introduction

The United States Army (the "Army") currently owns and operates a military family housing facility, consisting of real property (the "Land") and improvements (together, the "Facility"), as part of the Fort Hamilton Military Base. The Facility has deteriorated and is in need of considerable repair and rehabilitation if the Army is to provide suitable housing to its personnel. As described in greater detail below, the Army intends to lease the Land and transfer title to the improvements for 50 years to Petitioner, a Delaware limited liability company, which will demolish or rehabilitate the existing housing and improvements, construct new housing and improvements and rent the housing to Army and other military personnel. The Army and GMH Military Housing – Fort Hamilton LLC ("GMH"), a privately owned Delaware limited liability company, will be the only members of Petitioner. In connection with obtaining bond financing needed for the rehabilitation and construction of the Facility, Petitioner will sublease the Facility back to the Army which, in turn, will sub-sublease the Facility back to Petitioner. Both the sublease and the sub-sublease will be for terms of less than 49 years. No rent is required to be paid under any of the leases. A leasehold mortgage will be recorded with respect to each of the three leases. The Army will execute and record the leasehold mortgage on behalf of itself (as lessee under the sublease and lessor under the sub-sublease), and the Army will execute and record the leasehold mortgage on behalf of Petitioner (as lessee, sublessor and sub-sublessee).

A. The Project and the Housing Initiative

Like much of the Army's existing housing facilities across the country, the housing and related improvements that form the Facility at the Fort Hamilton Military Base are drastically in need of repair and rehabilitation. Petitioner was formed pursuant to the Military Housing Privatization Initiative of the 1996 Defense Authorization Act (the "Housing Initiative") for the purpose of designing, financing, constructing, rehabilitating, renovating, managing, operating and maintaining suitable military residential housing units and related ancillary facilities for the Army and other military personnel at the Facility (the activities and transactions concerning the Facility collectively constitute the "Project").

The Housing Initiative provides for the ownership, operation and management of military housing by non-governmental entities and authorizes the Department of Defense to invest through limited partnerships or other eligible entities which own, operate, and manage the housing. See P.L. 104-106 110 Stat. 186 (codified at 10 U.S.C. §§ 2871-2885). Specifically, the Housing Initiative authorizes the Secretary of Defense to "enter into contracts for the lease of military family housing units or military unaccompanied housing units to be constructed," and to "convey or lease [existing] property or facilities (including ancillary supporting facilities) to eligible entities for purposes of using the proceeds of such conveyance or lease to carry out activities" under the Housing Initiative. See 10 U.S.C. §§ 2874(a), 2878(a).

B. Petitioner

The Army and GMH will be the only members of Petitioner. Petitioner will be governed by an operating agreement (the "Operating Agreement"), which provides the Army with extensive rights (described below). GMH will serve as the manager of Petitioner. The initial capital of Petitioner will come from a capital contribution made by the Army and the proceeds of bonds secured by the leasehold mortgage that is the subject of this request. GMH will not be required to make any capital contribution to Petitioner for at least three years after the start of the Project, if ever. The amount of GMH's capital contribution, if any, will be determined at a future date and will be dependent upon future events, including varying construction and renovation costs incurred in the early stages of the Project. GMH will not be entitled to receive any distributions from Petitioner until it makes a capital contribution.

The Operating Agreement provides conditions and limitations on GMH's future distributions from Petitioner. Once GMH makes its capital contribution, it will be eligible to receive its share of distributions from available cash. Annual cash distributions are applied first to reduce debt, pay incentive management fees, and pay interest on GMH's adjusted capital investment. The remaining cash available for distribution will then be distributed 90% to the Army and 10% to GMH. However, GMH's annual distributions may not exceed 16.5% of its capital contribution. Upon dissolution, proceeds from the liquidation of Petitioner's assets will be distributed in a similar

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manner. The liquidating proceeds will be used to (1) pay off debts and set up reserves for contingencies, (2) make certain distributions to GMH, and (3) make distributions to the Army and GMH in accordance with the positive balances in their capital accounts. In the event proceeds from the liquidation of Petitioner's assets are insufficient to pay the distributions to GMH in (2) above, the agreement provides that the Army will release certain funds under its control to pay them.

GMH will receive no compensation for its role as manager of Petitioner, although an affiliate of GMH will receive a monthly property management fee over the term of the Project in return for its management services.

Petitioner will contract for all necessary services, including architectural, engineering and construction services, and will supervise demolition, renovation and construction, as applicable, of the housing and ancillary facilities in accordance with plans approved by the Army. Following construction, Petitioner will operate, manage and maintain the resulting residential units and related ancillary facilities in close cooperation with the Army and subject to rules and regulations specified by the Army for the remaining period of the ground lease (defined below). Additional rights and obligations of the parties in the Project are set forth in the Operating Agreement and the ground lease, which are summarized in the following paragraphs.

C. Proposed Transactions

The Army will lease the Land at the Fort Hamilton Military Base to Petitioner (the "Leased Property") pursuant to a ground lease (the "Ground Lease") for 50 years, with a 25 year renewal option. Pursuant to the Ground Lease, Petitioner will develop, maintain and operate the Facility. Petitioner is not required to pay any rent under the Ground Lease. Immediately after execution of the Ground Lease, Petitioner will sublease the Leased Property back to the Army (the "Army Sublease"), and the Army will then immediately sub-sublease the Leased Property back to Petitioner (the "Company Sublease"). Both the Army Sublease and the Company Sublease are tied to, and will expire upon termination of, the leasehold mortgage defined below.

The Ground Lease will provide that title to certain housing and ancillary facilities currently existing at the Facility (the "Existing Housing") will vest in Petitioner for no consideration. Title will, however, revert back to the Army upon termination of the Ground Lease. Petitioner will be obligated to demolish or substantially renovate most of the Existing Housing and to construct new residential units, which are intended to house military personnel and their families, and ancillary facilities, both pursuant to designs and specifications approved by the Army (the "New Housing") (the Existing Housing and the New Housing are referred to collectively as the "Housing"). As will be the case with the Existing Housing, title to the New Housing will vest in Petitioner pursuant to the Ground Lease, but only for the term of the Ground Lease. All right, title and interest in the Housing will revert to the Army upon expiration of the Ground Lease for no consideration.

D. Financing for the Project

To secure necessary financing to support the Project, Petitioner will issue approximately \$56 million of revenue bonds (the "Bonds") pursuant to a Master Indenture of Trust, Lockbox and Servicing Agreement (the "Master Indenture"). The Army and Petitioner have agreed to pledge certain interests in the Leased Property as security for the Bonds by executing a Mortgage, Assignment of Rents, Security Agreement and Financing Statement to the Master Trustee under the Master Indenture (the "Leasehold Mortgage"). The Leasehold Mortgage will have a term equal to the term of Bonds, which is currently estimated at 43 years. Through the Leasehold Mortgage, Petitioner will pledge its interests as lessee under both the Ground Lease and the Company Sublease and its interests as lessor under the Army Sublease. In addition, the Army, as mortgagor, will pledge its interests as lessee under the Army Sublease and as lessor under the Company Sublease. The Army will execute the Leasehold Mortgage on behalf of itself and Petitioner, and, will record it as required by the terms of the Leasehold Mortgage.

E. Army Control of the Project and Petitioner

Development of the Facility will be in furtherance of the Army's governmental functions. Pursuant to the Ground Lease, the Project will be under the general supervision of the Army, and certain actions undertaken by Petitioner will be subject to the Army's approval. As discussed above, the Army must approve all designs and specifications for the New Housing, and Petitioner is required to comply with all rules and regulations issued by the Army with respect to the Leased Property. Furthermore, the Army will maintain a significant degree of control over the Facility throughout the term of the Ground Lease. For instance: (1) the Army will have the right to enter the Leased Property for any purpose; (2) the Army may impose restrictions on access to the Leased Property by Petitioner; and (3) Petitioner is required to purchase from the Army or the Army's designee all police, fire and utility services.

In addition, the Army will limit rental rates Petitioner is allowed to charge for military personnel residing in the Housing to the applicable U.S. military service personnel "Basic Allowance for Housing," which is set on an annual basis by Congress and based upon such factors as geographic location, pay grade and dependency status of military personnel. This is the same rent currently paid by service members who live in the Existing Housing. Both the Army and Petitioner expect that 100% of the Housing will be rented to military personnel, and, accordingly, that all rental rates will be subject to the Basic Allowance for Housing.

Applicable law and regulations

Article 11 of the Tax Law imposes taxes on the recording of mortgages of real property measured by the principal debt or obligation secured or which under any contingency may be secured by the mortgage.

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Section 250(2) of the Tax Law provides, in relevant part:

The term "mortgage"... includes every mortgage or deed of trust which imposes a lien on or affects the title to real property, notwithstanding that such property may form a part of the security for the debt or debts secured thereby. An assignment of rents to accrue from tenancies, subtenancies, leases or subleases of real property, within any city in the state having a population of one million or more, given as security for an indebtedness, shall be deemed a mortgage of real property for purposes of [Article 11 of the Tax Law]....

Section 641.6(b)(3) of the Mortgage Recording Tax Regulations (the "Regulations") provides that "an instrument pledging the lessee's interest in a lease" constitutes a mortgage when given as security for a debt.

Section 644.1(a)(2) of the Regulations exempts the recording of "[m]ortgages where the mortgagor or mortgagee is the United States of America or any of its agencies or instrumentalities, to the extent immune from such taxes."

Section 644.1(a)(1) of the Regulations provides a similar exemption where the mortgagor or mortgagee is New York State or any of its agencies, instrumentalities or political subdivisions.

It is well established that government (State) agencies enjoy an immunity from taxation independent of the exemptions provided in the regulations for property utilized in the public interest. (*New York State Urban Development Corp.*, Adv Op Comm T&F, March 10, 1993, TSB-A-93(4)R)

In a March 29, 1913, opinion, the Attorney General opined that no mortgage recording tax was due when New York State acted as mortgagor and quoted the following passage from *Matter of Hamilton*, 148 NY 310, 313-314:

The property held by the state, or by any of its municipal divisions, for public purposes, is not, and never has been, subject to taxation.... The end and object of all taxation is to raise revenue for the purpose of defraying the expenses of government, and since no revenue could be raised by imposing taxes on property owned by the state itself, or by any of its political divisions, such property is in no just or practical sense the subject of taxation....

This principle has been applied in exempting from the mortgage recording tax the recording of mortgages on property the legal title of which is held by an industrial development agency and the beneficial ownership of which is held by a non-exempt private party. (See 1982 Opns St Comp No. 82-188, p 240; *One Park Place Associates*, Adv Op St Tx Comm, May 24 1982, TSB-A-82(1)(M); *New York State Urban Development Corp.*, *supra.*)

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In *Hotel Waldorf-Astoria Corp. v. State Tax Commission*, 86 AD2d 330, 334, in acknowledging that a \$45 million mortgage secured by the Waldorf-Astoria hotel was exempt from the mortgage recording tax because the mortgagee (the New York State Employees' Retirement System) was a New York State agency, the court stated: "as a State agency, the Retirement System enjoys an immunity from taxation independent of the statutory exemptions listed in Section 252 of the Tax Law...."

Also, in an informal opinion of the Attorney General, dated March 7, 1956, it was stated that:

It should be noted that section 257 of Article 11 of the New York State Tax Law is silent as to which party to the mortgage shall pay the tax. Under its terms the taxes shall be payable on the recording of each loan subject to tax so that the party who records is the one upon whom the tax is imposed.... (1956 Atty Gen [Inf Opns] 27, at 28.)

Opinion

Recently, *Battery Park City Authority*, Adv Op Comm T&F, June 5, 2002, TSB-A-02(2)R, recognized an exemption from the mortgage recording tax where an agency or instrumentality of New York State acts as either mortgagee or mortgagor. In particular, it was found that the petitioner was a New York State development authority that owned most of the area of Manhattan known as Battery Park City and was formed for the purpose of improving, replanning, reconstructing and redeveloping that area. In accordance with its purposes, the authority entered into a number of ground leases with private developers at different project sites. Costs of construction were to be funded by developer equity as well as by proceeds of one or more financings secured by mortgage(s) in which the development authority was a mortgagor. By virtue of a sublease from the developer to the development authority and then a sub-sublease from the development authority back to the developer, the development authority was able to secure the financings with its interests in the sublease and the sub-sublease without pledging its fee simple interest in the property. The advisory opinion concluded that the subject mortgage could be recorded without payment of mortgage recording taxes on the ground that the State agency was a co-mortgagor and recorded the mortgage.

Similar to the State agency in *Battery Park City Authority*, *supra*, the Army, an agency of the United States of America, will enter into the Ground Lease with Petitioner for the purpose of constructing, rehabilitating, renovating, managing and maintaining residential units and related ancillary facilities at the Fort Hamilton Military Base, as authorized by Congress under the Housing Initiative. Likewise, the Army will be named the co-mortgagor in one or more mortgages on the leasehold interests and will be the party who records the mortgages. Given the provisions of section 644.1(a)(2) of the Regulations and the Attorney General's opinion dated March 7, 1956, and in light of the long established doctrine that the United States government, its agencies, and instrumentalities are exempt from taxation unless such taxation has been consented to by Congress, the recording of

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the mortgages by the Army in this case would be exempt from taxation (see *Department of Employment v. U.S.*, 385 U.S. 355 (1966); *United States v. State Tax Commission of Mississippi*, 421 U.S. 599 (1975); *Pittman v. Home Owners Loan Corporation*, 308 U.S. 21 (1939)).

Accordingly, since the proceeds of the mortgage will be used by the Petitioner for a government purpose, namely, the rehabilitation and reconstruction of military housing units located at Fort Hamilton Military Base, and the Army will execute and record the leasehold mortgages as a mortgagor, the mortgages may be recorded without payment of the mortgage recording taxes imposed under and pursuant to Article 11 of the Tax Law.

DATED: April 28, 2004

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.