SPONSOR'S JUSTIFICATION FOR SENATE BILL 318:

Mezzanine debt and preferred equity investment are forms of unsecured debt often used to fund the purchase of investment properties. As these debts are not secured against a property like a traditional mortgage, the lender's decision to issue the debt is based on the credit worthiness of the borrower. As a result, these types of debt instruments are not available to everyday homebuyers, but rather to the institutional investors and the extremely wealthy who purchase real estate with the goal of making a profit.

While mezzanine debt and preferred equity investments used to finance real estate purchases serve the same purpose as a mortgage, they are not publicly recorded in the same way. The lack of transparency is problematic: real estate speculators have a history of financing their purchases of occupied rental housing with mezzanine debt--sometimes the only type of financing they can acquire due to the riskiness of their investments--and then rapidly raising rents to pay back the debt obligation. Regulators and advocates with access to publicly recorded mortgage notes can calculate a property's debt service coverage ratio, which can help identify an overleveraged building where rents are likely to skyrocket, displacing tenants. But when a loan's term sheet is hidden, as is the case with mezzanine debt, the public remains in the dark and therefore vulnerable. Because the state lacks adequate oversight over these types of debt, real estate speculators who want to shroud their predatory business models from the public eye are incentivized to use these types of financing as opposed to funding their property acquisitions with a traditional bank-backed mortgage.

Not only are mezzanine debt and preferred equity investments currently invisible to the public, they are also untaxed. With the astronomical sums trading hands in real estate transactions with mezzanine debt playing a major role, the state is currently forgoing possibly billions of dollars of potential tax revenue that the state desperately needs to fund unmet capital needs in its public housing.

This commonsense legislation creates parity between debt instruments that serve the same purpose but are currently treated differently under the law with the goal of steering real estate speculators towards ostensibly less volatile instruments provided by banks rather than private equity. This legislation also creates more transparency in the market, and raises badly needed tax revenue from corporations that can afford to pay their fair share.

SOCIAL JUSTICE IMPACT:

This legislation creates more transparency in the market, helps to prevent community de-stabilization, and raises desperately needed tax revenue from corporations and other entities that can afford to pay their fair share. This additional revenue can and should be used to fund schools, hospitals, and other much-needed public services.