

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

House Bill 172

(Delegate McIntosh and the Speaker, *et al.*)
(By Request - Administration)

Environmental Matters

Judicial Proceedings

**Real Property - Ground Rents - Prohibition on Creation of Reversionary
Interests in Residential Property**

This emergency Administration bill prohibits, beginning January 22, 2007, the creation of new residential ground rents. The owner of a fee simple or leasehold estate in residential property that is used, intended to be used, or authorized to be used for four or fewer dwelling units may not create a reversionary interest in the property under a ground lease or sublease for a term of years renewable forever subject to the payment of a periodic ground rent.

Fiscal Summary

State Effect: Prohibiting the creation of new ground rents would not materially affect governmental finances or operations.

Local Effect: The bill would not directly affect local finances.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Analysis

Current Law: Leasehold estates of the type prohibited by the bill are recognized at common law and are not prohibited by statute for residential or commercial properties.

Background: While ground rents are recognized in other states, Maryland's system is unique. In Maryland, a ground rent creates a leasehold estate in the grantee. The leasehold estate is personal – not real – property. The grantor retains a reversion in the ground rent property and the fee simple title to the land. Ground rents generally have a 99-year term and renew perpetually. Ground rent is paid to the grantor (the ground rent holder) for the use of the property for the term of the lease in annual or semi-annual installments. Under a typical ground rent contract, the tenant agreed to pay all fees, taxes, and other costs associated with ownership of the property.

Ground rents have been a form of property holding in Maryland since colonial times, with some of the earliest known leases dating to 1750. The purpose of these ground rents was to produce income for their grantors. Most ground rents in colonial times required the tenant to erect improvements on the property. Maryland's unique system of ground rents can be traced to wording in its colonial charter from Charles I that prohibited certain feudal tenures, specifically those that would reserve a rent in a grantor who has transferred fee simple title. The 99-year lease was devised to reserve a ground rent without violating Maryland's colonial charter.

Prior to 1884, a ground rent could be redeemable or irredeemable by the terms of the lease. A redeemable ground rent would state the terms under which the tenant could redeem the lease and take fee simple ownership of the property. Generally, a tenant cannot take fee simple ownership of an irredeemable ground rent. When the General Assembly prohibited the creation of irredeemable ground rents beginning April 9, 1884, the General Assembly also established a method of calculating the redemption value.

Chapter 464 of 2003 established an alternative method for redeeming a ground rent if the tenant is unable to locate the ground rent holder, which had become a problem with some of the older ground rents. Under this method, the tenant must submit specified documentation and pay associated fees to the State Department of Assessments and Taxation (SDAT).

In the 20th Century, developers used ground rents as part of their overall business strategy. Properties subject to ground rent could reduce the purchase price to a home buyer, who might then be better able to afford a mortgage. In the earlier part of the century, a developer would sell houses in a development and retain the ground rent as a steady long-term income source. Later in the century, developers began securitizing and selling the ground rents to finance further developments. Many of these ground rents were held by institutional investors who saw them as long-term, low-risk investments.

When a tenant fails to pay rent, the ground rent holder may bring an action for the past-due rent or for possession of the premises. In either case, the ground rent holder is limited by statute to three years' past-due rent. Because the tenant has a leasehold estate,

a tenant whose property is seized in an ejectment action (an action to retake the premises) receives no other compensation. The ground rent holder is then free to release the property under the ground rent or sell the property in fee simple.

Chapter 80 of 2003 established limits on the amounts that ground rent holders could receive as reimbursement for expenses received for actions to collect past due rent and for an ejectment action. A holder of a ground rent that is at least six months past due is entitled to reimbursement for actual expenses of up to \$500 to collect the past-due amount. In an ejectment action, the ground rent holder is entitled to filing fees and court costs, costs related to process service or other notice, title searches up to \$300, attorney's fees up to \$700, and taxes paid.

Recent newspaper accounts noted a sharp increase in the number of ejectment actions filed in the Circuit Court for Baltimore City during the last five years.

According to estimates from Baltimore City and SDAT, properties subject to ground rents are concentrated mostly in Baltimore City (74,085), with some properties located in Anne Arundel (5,000), Baltimore (35,705), Harford (1,500), Howard (200), Talbot (10), and Worcester (250) counties. None of the existing ground rents would be affected by this bill. SDAT advises that new ground rents have recently been created.

Baltimore City has identified 234,943 separate properties in the city, of which 214,604 have been transferred since 1982. City records indicate that 74,085 of the properties transferred have a ground rent. Of the properties transferred with a ground rent, 67,861 were residential properties with one to four dwelling units. None of these existing ground rents would be affected by this bill.

Additional Information

Prior Introductions: A similar bill, SB 489 of 2006, received an unfavorable report from the Senate Judicial Proceedings Committee.

Cross File: SB 106 (Senator Della and the President, *et al.*) (By Request – Administration) – Judicial Proceedings.

Information Source(s): State Department of Assessments and Taxation; Department of Labor, Licensing, and Regulation; Baltimore City; Department of Legislative Services

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