SB 883

Department of Legislative Services

Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 883 (Senator Conway, *et al.*)
Education, Health, and Environmental Affairs Environmental Matters

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Ground Leases - Redemption - Preferred Interest Rate Loans

This bill alters the purpose of the Maryland Home Financing Program to include making preferred interest rate loans to households that meet income standards for the redemption of ground leases on their principal residences. The amount of the loan may also include transactional costs associated with the redemption. The Department of Housing and Community Development (DHCD) is required to establish the income standards. DHCD must set appropriate terms for the loans, including deferred payments on principal and interest. DHCD may set the maximum amount of a loan under the bill, including the maximum amount that may be used for transactional costs.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: Special fund expenditures could increase by approximately $24,400 in FY 2008 and $21,500 in FY 2009 to process applications for loans under the bill. The bill merely alters the purpose for which money in the Maryland Home Financing Program may be spent and would not affect the overall amount of financing for this program.

(in dollars)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Revenues	$0	$0	$0	$0	$0
SF Expenditure	24,400	21,500	0	0	0
Net Effect	($24,400)	($21,500)	$0	$0	$0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law: The purposes of the Maryland Home Financing Program include making, participating in making, and purchasing:

- preferred interest rate loans to acquire, acquire and rehabilitate, or refinance a primary residence by specified persons;
- short-term construction loans to developers or nonprofit sponsors to construct or rehabilitate dwelling units that households of limited income can afford;
- short-term loans to specified nonprofit sponsors to acquire and either construct or rehabilitate dwelling units that households of limited income can afford to buy under a purchase or lease-purchase contract;
- emergency assistance loans to households of limited income who cannot make current mortgage payments on their homes and risk forfeiting the titles to their homes under specified circumstances; and
- reverse equity loans to elderly households of limited income for specified purposes.

There is no State-operated loan program to assist households to redeem ground leases on their principal residences.

A ground rent established on or after April 9, 1884 may be redeemed by the tenant. The tenant must give the ground rent holder one month's notice and pay:

- an amount equal to the annual rent multiplied by:
    - 25, which is capitalization at 4%, if the lease was executed from April 8, 1884 to April 5, 1888;
    - 8.33, which is capitalization at 12%, if the lease was executed after July 1, 1982; or
    - 16.66, which is capitalization at 6%, if the lease was executed at any other time;
- a lesser sum, if specified in the lease; or
- a sum to which the parties may agree at the time of redemption.

If the lease was executed after July 1, 1982, the reversion is redeemable five years after the date of the lease. If the lease was entered before that time, it may be redeemed at any time.

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 twentieth Century, developers used ground rents as part of their overall business strategy. Properties subject to ground rent could reduce the purchase price to a homebuyer, 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. 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.

State Expenditures: The estimated number of properties in the State subject to a ground rent is 116,750. The number of these that would meet the loan criteria is unknown, but DHCD could receive a large number of applications in fiscal 2008 and 2009. It is assumed that the number of potential applicants would decrease as homeowners redeem their ground rents. Accordingly, special fund expenditures could increase by an estimated $24,415 in fiscal 2008, which accounts for the bill's October 1, 2007 effective date. This estimate reflects the cost of hiring one half-time contractual administrative assistant to process applications under the bill in fiscal 2008 and 2009. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Contractual Salary	$20,221
Other Operating Expenses	4,194
Total FY 2008 State Expenditures	**$24,415**

Fiscal 2009 expenditures of $21,539 reflect: (1) a full salary with a 4.5% increase and 6.8% employee turnover; and (2) a 1% annual increase in ongoing operating expenses.

DHCD has discretion in how to allocate funds among its financing programs. Of the $7.5 million special fund pay-as-you-go (PAYGO) capital money in the fiscal 2008 budget allowance for home ownership programs, DHCD currently anticipates that it will allocate $500,000 to the Maryland Home Financing Program. DHCD would continue to have discretion in how it allocates funding among its financing programs and within this program. The overall funding amount would not be affected by the bill.

The amount of money required to redeem a ground rent differs and depends on the amount of the annual ground rent and the year when the ground rent was created. The redemption amount could range anywhere from $1,700 to $3,300, with a typical amount being around $2,500.

Additional Information

Prior Introductions: None.

Cross File: HB 1284 (Delegate McHale, *et al.*) – Environmental Matters.

Information Source(s): Department of Housing and Community Development, State Department of Assessments and Taxation, Department of Legislative Services

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