

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 397

(Senator Gladden, *et al.*)

Judicial Proceedings

Environmental Matters

Ground Rents - Conversion of Irredeemable Ground Rents

This bill authorizes the conversion of an irredeemable ground rent to a redeemable ground rent.

The bill applies to residential property used, intended to be used, or authorized to be used for four or fewer dwelling units. The bill does not apply to property leased for other specified uses.

Fiscal Summary

State Effect: The bill would not directly affect State finances or operations.

Local Effect: Some irredeemable ground rents on properties owned by Baltimore City may be converted to redeemable ground rents. Any cost associated with redeeming such ground rents would be offset by future savings from ground rent payments.

Small Business Effect: Minimal.

Analysis

Bill Summary: An irredeemable ground rent becomes converted to a redeemable ground rent unless a notice of intention to preserve the irredeemability is recorded in the land records within the time period allotted under the bill. The conversion occurs on the day following the end of the period in which the notice may be recorded. A disability or lack of knowledge does not prevent the conversion if the notice is not filed within the allotted time period.

Any ground lease holder of an irredeemable ground rent may record a notice of intention to preserve irredeemability in the land records. To be effective and entitled to be recorded, the notice must be notarized and must include specified information about the ground rent. A notice that substantially meets the bill's requirements must be accepted for recording on payment of the same fees that are charged for recording a deed. The bill specifies that the filing is exempt from a State or local excise tax and how the notice must be indexed.

To preserve a ground rent's irredeemability, a notice of the intention to preserve it must be recorded by December 31, 2010. If the notice is not recorded before that time, the ground rent becomes redeemable. If a notice is recorded before December 31, 2010, the ground rent remains irredeemable for 10 years, through December 31, 2020. The notice lapses on January 1, 2021, unless a renewal notice is recorded within six months before the notice expires. Subsequent renewal notices lapse after 10 years, unless another renewal notice is recorded within 6 months before their expiration. If a notice lapses, the ground rent becomes redeemable.

A ground rent made redeemable under the bill is redeemable at any time following its conversion to redeemable status. The redemption amount is the annual rent reserved multiplied by 16.66, which is capitalization at 6%.

Current Law: Ground rents executed prior to April 9, 1884 could be redeemable or irredeemable, depending on the terms of the lease. A ground rent established on or after that date 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 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 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.

Local Fiscal Effect: Baltimore City advises that it pays approximately \$36,275 annually in ground rent on 722 properties in a database maintained by its housing department. The city has expressed concern that it may be liable for ground rent on an additional 1,800 properties for which it has not received a bill. It is unknown how many of these properties are subject to irredeemable ground rents. To the extent that properties owned by Baltimore City are subject to irredeemable ground, the city would be able to take fee simple ownership. Any costs associated with redemption would be offset by a reduction in future ground rent payments. Any effect on property values caused by the removal of an irredeemable ground rent cannot be accurately estimated but is assumed to be minimal.

Additional Information

Prior Introductions: None.

Cross File: HB 452 (Delegate Rosenberg and the Speaker, *et al.*) (By Request – Administration) – Environmental Matters.

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