

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 334

(Senators Kelley and Frosh)

Judicial Proceedings

Environmental Matters

Real Property - Deposits on New Homes - Escrow Accounts

This bill clarifies the circumstances which determine when, and for what length of time, a builder or vendor of a new single-family home must maintain an escrow account, surety bond, or irrevocable letter of credit to hold a deposit paid by the purchaser. The vendor or builder may make withdrawals from an escrow account, consisting of sums received to finance the construction of a residential unit to pay, in accordance with a written draw schedule approved by the purchaser, documented claims of persons who have furnished labor or material for construction of the new home. The bill also requires that any money received by a vendor or builder in connection with the sale and purchase of a new single-family home must be held in a trust for the benefit of the purchaser and that any payments for labor or material must be consistent with the trust obligation.

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: If the Consumer Protection Division of the Office of the Attorney General receives fewer than 50 complaints per year stemming from the bill, the additional workload can be handled with existing resources. No effect on revenues.

Local Effect: The bill does not directly affect governmental operations or finances.

Small Business Effect: Potential minimal.

Analysis

Bill Summary: The bill clarifies that if a vendor or builder of a new home receives any sum of money from the purchaser any time prior to the completion of the home, including

prior to the start of construction, the vendor or builder must place the sum in an escrow account, obtain and maintain a corporate surety bond, or obtain and maintain an irrevocable letter of credit from a Maryland bank.

The bill also clarifies that the vendor or builder must maintain the escrow account, corporate surety bond, or irrevocable letter of credit until the earlier of (1) the granting of a deed to the property on which *a completed* home is located to the purchaser; (2) the return of the money to the purchaser; or (3) the forfeiture of the money by the purchaser under the terms of the home's contract of sale.

A banking institution or national banking association, at which an escrow account is established, is not responsible for a withdrawal from the escrow account by the vendor or builder.

Current Law: If a vendor or builder of a new single-family home not completed by the time of contracting a sale receives any money from the purchaser, the vendor or builder must:

- place the money in an escrow account segregated from all other funds of the vendor or builder;
- obtain and maintain a corporate surety bond in a specified form and amount; or
- obtain and maintain a irrevocable letter of credit issued by a Maryland bank in a specified form and amount.

The vendor or builder must maintain the escrow account, surety bond, or irrevocable letter of credit until the earlier of (1) the granting of a deed to the property on which the home is located to the purchaser; (2) the return of the money to the purchaser; or (3) the forfeiture of the money by the purchaser under the terms of the contract of sale.

A vendor or builder may deposit trust moneys into a noninterest bearing checking account, one or more savings accounts, or any combination of accounts in financial institutions authorized by federal or State law to do business in the State. A vendor or builder may invest trust moneys in any other investment vehicle specified by the client or beneficial owner or as they and the licensee agree.

Background: The bill is in response to a recent Maryland Court of Special Appeals case. In *Coleman v. State of Maryland* (No. 1559, filed December 28, 2010), the Court ruled that the Deposit on New Homes subtitle is ambiguous as to the circumstances in which the builder or vendor is required to maintain an escrow account.

A builder contracted with several purchasers to convey lots and then construct a house on each lot. Each of the purchasers paid between \$2,250 and \$3,500 as a deposit for

blueprints. While approximately \$2,500 of these funds were placed in the builder's escrow account, the majority were placed in the builder's operating account. Subsequently, each of the purchasers obtained construction loans from banks and, using an initial advance from the loan, purchased the property in which each house was to be located. The remaining balance went into a construction escrow account, to be paid as the builder incurred construction costs. The builder never made a withdrawal from the construction escrow; the homes were never built; and some of the purchasers defaulted on their loans.

The Maryland Custom Homes Protection Act (MCHPA) states that, if a vendor or builder requires the purchaser of a new home to pay any money and the vendor or builder receives a sum of money before completion of the unit, the builder or vendor must establish an escrow account and take other actions as specified. The escrow account must be maintained until the earlier of (1) the granting of a deed to the property on which the residential unit is located to the purchaser; (2) the return of the money to the purchaser; or (3) forfeiture of the money by the purchaser under terms of a contract of sale for the residential unit. The Court noted that clearly the intent of the legislature was to protect purchasers in certain transactions involving new homes from dishonest vendors and builders who might require deposits prior to a conveyance and take the money without completing construction. The Court ruled that the type of conveyance that meets the requirements of the statute is ambiguous. In this case, the contracts at issue specifically identified the portion of the purchase price allocated to the purchase of the lot. Once the construction loans were settled, each purchaser received the deed to his or her lot. Once the land was conveyed to the purchasers, the protections afforded by an escrow account were no longer needed, since each purchaser had obtained a construction loan that had a construction escrow and a drawdown schedule.

The Court found that MCHPA was not designed to address a situation where the deed to the land on which a residential unit is to be built and the deed to a completed residential unit occur at different times. It was not clear that the builder violated the statute by withdrawing escrow money after conveying deeds to the land, although no homes had been built. Arguably, a conveyance occurred, although not the conveyance of finished homes that the purchasers were expecting. Because violation of this provision of MCHPA is a criminal offense, any ambiguity must be resolved in favor of the builder. As a result, the Court of Special Appeals reversed the Circuit Court of Prince George's County. The bill is intended to establish that a builder must open an escrow account for deposits even if construction on a new house has not yet begun and the account must be maintained until the granting of a deed for a completed home.

Additional Information

Prior Introductions: None.

Cross File: HB 379 (Delegate Niemann, *et al.*) - Environmental Matters.

Information Source(s): Office of the Attorney General (Consumer Protection Division); Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Department of Legislative Services

Fiscal Note History: First Reader - February 15, 2011
ncs/kdm Revised - Senate Third Reader - March 30, 2011

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