

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

Senate Bill 429 (Senator Klausmeier)
Judicial Proceedings

Real Property - Residential Leases - Interest on Security Deposits

This bill authorizes a landlord to choose to set the rate of interest that must accrue on a tenant's security deposit at either 3% annually or 1 percentage point below the Federal Reserve Board's discount rate as of January 1 of each year. The landlord must state the chosen rate in the tenant's written lease. If the landlord fails to state the rate of interest in the lease, the rate must be 3% per year.

Fiscal Summary

State Effect: General fund expenditures for the Consumer Protection Division of the Attorney General's Office increase by \$29,000 in FY 2012 with the addition of one part-time employee to handle the anticipated additional complaint volume. Future year expenditures reflect annualization and inflation. Revenues are not affected.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	29,000	34,600	36,300	38,000	39,900
Net Effect	(\$29,000)	(\$34,600)	(\$36,300)	(\$38,000)	(\$39,900)

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

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

Small Business Effect: Potential meaningful.

Analysis

Current Law: “Security deposit” is defined as any payment of money to a landlord by a tenant for the purposes of protecting the landlord against nonpayment of rent, damages

due to a breach of the lease, or damages to the leased premises, common areas, major appliances, and furnishings. A security deposit may include advance payment of last month's rent.

A security deposit may not be greater than the equivalent of two month's rent per dwelling unit. The landlord must provide the tenant with a receipt notifying the tenant of his or her rights regarding the security deposit. Additionally, the landlord must hold all security deposits in specified federally insured financial institutions doing business in the State. The accounts must be devoted exclusively to the security deposits and bear interest. The landlord must deposit the security deposit into this account within 30 days of receipt. The interest must accrue at six-month intervals from the day the tenant gives the landlord the security deposit.

Within 45 days after the contractual end of a tenancy, the landlord must return the security deposit to the tenant, less any damages rightfully withheld. In addition to the principal of the security deposit, the landlord must return simple interest that has accrued in the amount of 3% per annum. If the landlord fails to return this amount within the specified time without a reasonable basis, the tenant may bring an action for up to three times of the withheld amount and reasonable attorney's fees.

If a tenant has been ejected or evicted or has abandoned the property prior to the termination of the tenancy, the landlord is not required to return the security deposit unless the tenant provides written notice to the landlord demanding return of the security deposit. This notice must be sent by first-class mail within 45 days of being evicted or ejected or of abandoning the premises. The landlord, within 45 days of receipt of this demand, must send, by first-class mail, a list of any damages and return the security deposit, less any damages rightfully withheld. If the landlord fails to send the list of damages as required, the landlord forfeits the right to withhold any part of the security deposit for damages. In addition to the principal of the security deposit, the landlord must return simple interest that has accrued in the amount of 3% per annum. If the landlord fails to return this amount within the specified time, the tenant may bring an action for up to three times of the withheld amount and reasonable attorney's fees.

Background: The Federal Reserve Board discount rate is the interest rate charged to eligible commercial banks and other depository institutions on loans received from the 12 regional Federal Reserve Banks. The discount rate is set by the board of directors of each Federal Reserve Bank every 14 days and is subject to review by the board of governors of the Federal Reserve System. If a financial institution's capital reserves drop below the reserves requirement established by the board of governors, funds borrowed from the Federal Reserve are typically used to correct that shortage.

The discount rate is used by the Federal Reserve to control the monetary supply, which in turn, influences inflation and interest rates. The more money available, the more likely inflation will occur. Raising the discount rate makes it expensive to borrow from the Federal Reserve, which lowers the supply of available money, thus increasing short-term interest rates. Lowering the discount rate has the opposite effect, in turn, bringing short-term interest rates down. Historical Federal Reserve Board discount rates are shown in **Exhibit 1**.

Exhibit 1
Federal Reserve Board Historical Discount Rates
January 1, 2001 through January 1, 2011

<u>Date</u>	<u>Discount Rate</u>
January 1, 2011	0.75%
January 1, 2010	0.50%
January 1, 2009	0.50%
January 1, 2008	4.75%
January 1, 2007	6.25%
January 1, 2006	5.25%
January 1, 2005	3.25%
January 1, 2004	2.00%
January 1, 2003	0.75%
January 1, 2002	1.25%
January 1, 2001	6.00%

Source: Federal Reserve Board

Chapter 2 of 1973 imposed the duty on a landlord to pay interest on a tenant's security deposit at 3% simple interest, accruing at six-month intervals. Chapter 536 of 1980 increased the interest rate that must be paid on a security deposit from 3% to 4%. Chapter 369 of 2004 lowered the required interest rate to be paid on a tenant's security deposit to 3%.

Several neighboring states have statutes regarding the return of accrued interest on a security deposit. For example, security deposits in the Commonwealth of Virginia must accrue interest at a rate equal to four percentage points below the current year's Federal Reserve Board's discount rate. However, no accrued interest is returned unless the landlord has held the deposit for a period exceeding 13 months after the effective date of the rental agreement. In Virginia, when the Federal Reserve discount rate is at or below 1% as of January 1 of a particular year, a tenant's security deposit accrues no interest.

New Jersey law requires landlords who rent more than 10 apartments to place the deposit in either an insured money market fund or a federally insured bank account. The rate of interest must equal the average rate the bank pays on a money market fund. Landlords who rent fewer than 10 apartments must place the security deposit in an account that pays at least the regular rate of interest. Landlords are required to pay tenants, or subtract from the rent, the interest earned on the deposit each year.

State Expenditures: General fund expenditures for the Consumer Protection Division increase by \$29,032 in fiscal 2012, which accounts for the bill's October 1, 2011 effective date. This estimate reflects the cost of hiring one part-time mediation unit supervisor to handle the additional complaints generated by the change in accrued interest on a security deposit, particularly cases in which the lease states the simple interest that is accrued on a tenant's security deposit is one percentage point below the Federal Reserve Board's discount rate and the discount rate is 1% or less on January 1 of that year. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position (Full-time Equivalent)	0.5
Salary and Fringe Benefits	\$23,021
Operating Expenses	<u>6,011</u>
Total FY 2012 State Expenditures	\$29,032

Future year expenditures reflect a full salary with 4.4% annual increases and 3% employee turnover as well as 1% annual increases in ongoing operating expenses.

Small Business Effect: The decrease in the simple amount of interest accrued on a security deposit from 3% to one percentage point below the Federal Reserve Board's discount rate on January 1 of each year could have a meaningful effect on property management companies. As shown in **Exhibit 1**, the discount rate has been below 1% for the past three years. The amount saved by the decrease depends on the number of properties rented, the amount of security deposit collected, and the rental properties' turnover rates.

Additional Comments: The bill does not specify the rate of interest a landlord must pay on a security deposit if the lease states that the rate of interest is one percentage point below the Federal Reserve Board's discount rate and the discount rate is 1% or less on January 1 of that year. The above expenditures are based on the Attorney General's assumption that a tenant may be required to absorb this difference.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Office of the Attorney General (Consumer Protection Division); Judiciary (Administrative Office of the Courts); New Jersey Code; Virginia Code; Federal Reserve Board; Department of Legislative Services

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mlm/kdm

Analysis by: Michael F. Bender

Direct Inquiries to:
(410) 946-5510
(301) 970-5510