

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 1162 (Delegate McMillan)
Environmental Matters

Ground Leases - Registration, Remedies, and Reorganization of Provisions

This bill prohibits a ground lease holder of an unregistered ground lease from bringing a civil action against a leasehold tenant seeking a money judgment for the amount of any ground rent due. The bill repeals authority for (1) the extinguishment of the reversionary interest of a ground lease holder for failure to register a ground lease with the State Department of Assessments and Taxation (SDAT) prior to September 30, 2010; and (2) attachment of a lien as a remedy for nonpayment of a ground rent. The bill requires SDAT to prepare a Deed of Redemption that contains specified information. The fee for recording the deed is \$10, and the clerk of the county in which the deed is recorded must forward a copy to SDAT. The bill authorizes a ground lease holder to collect a specified amount of reimbursement for actual expenses incurred in the collection of past-due ground rent if the ground lease holder meets specified notice requirements. The bill also clarifies and reorganizes several provisions of current State law relating to ground leases.

Fiscal Summary

State Effect: General fund expenditures increase by \$472,500 in FY 2013 and \$50,000 in subsequent years for SDAT to prepare a Deed of Redemption for each redeemed ground lease. General fund revenues increase by \$9,500 in FY 2013 and \$1,000 in subsequent years due to fees collected for recording a Deed of Redemption. Special fund revenues increase by \$37,800 in FY 2013 and \$4,000 in subsequent years due to the surcharges collected from recording a Deed of Redemption.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	\$9,500	\$1,000	\$1,000	\$1,000	\$1,000
SF Revenue	\$37,800	\$4,000	\$4,000	\$4,000	\$4,000
GF Expenditure	\$472,500	\$50,000	\$50,000	\$50,000	\$50,000
Net Effect	(\$425,300)	(\$45,000)	(\$45,000)	(\$45,000)	(\$45,000)

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

Local Effect: The bill's changes may be handled with existing budgeted resources.

Small Business Effect: Minimal.

Analysis

Bill Summary: A holder of a ground rent that is at least six months in arrears is entitled to reimbursement for actual expenses of up to \$500 incurred in the collection of that past-due ground rent and the fulfillment of the bill's notice requirements, including (1) title abstract and examination fees; (2) judgment report fees; (3) photocopying and postage fees; and (4) attorney's fees.

Upon filing an action for ejectment, the plaintiff or holder of a ground rent is entitled to reimbursement for reasonable expenses incurred in the preparation and filing of the ejectment action, including (1) filing fees and court costs; (2) expenses incurred in the service of process or otherwise providing notice; (3) specified title abstract and examination fees not exceeding \$300; (4) reasonable attorney's fees not exceeding \$700; and (5) taxes, including interest and penalties, that have been paid by the plaintiff or holder of a ground rent.

To be reimbursed for the expenses listed above, the holder of the ground rent must send a specified notice to the tenant at least 30 days before taking any action. The notice must be in the required format and state the amount due and a warning that, unless the past-due ground rent is paid within 30 days, legal action may be taken and the tenant will be liable for specified expenses and fees. The holder of the ground rent must mail the notice by first-class mail to the tenant's last known address as shown in the records of SDAT and obtain a certificate of mailing from the U.S. Postal Service.

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

Ground leases 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 leases was to produce income for their grantors. Most ground leases in colonial times required the tenant to erect improvements on the property. Maryland's unique system of

ground leases 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 lease without violating Maryland's colonial charter.

In the Twentieth Century, developers used ground leases as part of their overall business strategy. Properties subject to ground leases 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 lease as a steady long-term income source. Later in the century, developers began securitizing and selling the ground leases to finance further developments. Many of these ground leases were held by institutional investors who saw them as long-term, low-risk investments.

Prior to 2007, when a tenant failed to pay rent, the ground lease holder could bring an action for the past-due rent or for possession of the premises. In either case, the ground lease holder was limited by statute to three years' past-due rent. Because the tenant had a leasehold estate, a tenant whose property was seized in an ejection action (an action to retake the premises) received no other compensation. The ground lease holder was then free to release the property under the ground rent or sell the property in fee simple.

A series of *Baltimore Sun* articles in 2006 noted a sharp increase in the number of ejection actions due to ground leases. In 2007, the General Assembly passed seven bills addressing ground leases. One of these bills, Chapter 286 of 2007, altered the remedy for nonpayment of ground rent on residential property. The bill abolished ejection and provided for the creation of a lien if ground rent is unpaid at least six months after its due date, notwithstanding any provision in a ground lease giving the ground lease holder the right to reenter the property. The ground lease holder must give written notice to the leasehold tenant against whose property the lien is intended to be imposed and each mortgagee or trustee of the record.

Historically, a tenant could only redeem a ground rent established on or after April 9, 1884. Ground rents executed prior to April 9, 1884, could be redeemable or irredeemable, depending on the terms of the lease. Redeeming a ground rent allows a tenant to make a specified payment and take fee simple ownership of the property. Chapters 289 and 291 of 2007 established a process to convert an irredeemable ground rent to a redeemable ground rent and repealed the waiting period before a ground rent may be redeemed, respectively. 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.

A ground rent made redeemable under Chapter 289 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%.

If the tenant is unable to locate the ground rent holder, the ground rent may be redeemed through an alternative method. Under this method, the tenant must submit specified documentation and pay associated fees, along with the redemption amount and up to three years' back rent, to SDAT.

Furthermore, Chapter 290 of 2007 required ground lease holders to register the ground lease with SDAT prior to September 30, 2010. If the ground lease holder failed to register, the holder's reversionary interest is extinguished and ground rent is no longer payable. SDAT was then required to issue a ground lease extinguishment certificate to the tenant. The extinguishment conclusively vested a fee simple title in the leasehold tenant, free and clear of any and all right, title, or interest of the ground lease holder, the ground lease holder's lienholders, and any person claiming by, through, or under the ground lease holder when the certificate is accepted for recording in the land records.

SDAT reports that 85,000 ground leases were registered prior to the September 30, 2010 deadline. SDAT issued 1,160 extinguishment certificates to tenants of the ground lease holders who had not registered. In 2011, the Maryland Court of Appeals held that the extinguishment and transfer provisions of Chapter 290 were unconstitutional under Maryland's Declaration of Rights and Constitution. *Muskin v. State Dept. of Assessments and Taxation*, 422 Md. 544 (2011). However, the court did hold that the registration requirements were valid.

In the *Muskin* case, the plaintiff was the trustee for two trusts that owned 300 ground rent leases in Baltimore City. Instead of registering the ground rent leases on behalf of the trusts, Mr. Muskin filed suit in the Circuit Court for Anne Arundel County, requesting a declaratory judgment and injunction on the grounds that the ground lease registration

program was unconstitutional. The Court of Appeals agreed with the plaintiff that the provisions authorizing extinguishment of ground rent leases and transfer of property rights to homeowners are unconstitutional under the Maryland Declaration of Rights and the Maryland Constitution, as they retroactively diminished the vested property rights of ground lease holders. The court stated that Chapter 290 unconstitutionally takes private property from ground lease holders without just compensation. The court also indicated that the errors in the law included the absence of notice and an opportunity for a hearing before the extinguishment of a ground lease holder's reversionary interest. The court suggested that alternative statutory approaches might include one where failure to register a ground lease triggers an interim consequence, such as restrictions on collecting ground rents prospectively or a denial of access to the courts for collection of unregistered ground rents.

SDAT began to take new ground lease registrations after the Court of Appeals decision. Ground lease holders have registered an additional 475 ground rents since the registry reopened. Additionally, SDAT issued letters to each tenant who received an extinguishment certificate advising the tenant that the certificate is no longer valid.

Additionally, there is a pending Anne Arundel County Circuit Court case, *Stanley Goldberg, et al. v. State*, deciding the constitutionality of Chapter 286 of 2007. As noted above, Chapter 286 eliminated ejectment as a remedy for nonpayment of ground rent and replaced it with a process to create and foreclose on a lien. The plaintiff claims that the retroactive elimination of the remedy of ejectment amounts to a taking of private property without just compensation. The circuit court has issued an "interlocutory order" holding that the statute is unconstitutional. An interlocutory order is a temporary order and may not be appealed until a final order is entered. A final order is expected in spring 2012.

Ground leases are concentrated mostly in Baltimore City (57,781), with some properties located in Anne Arundel (3,454), Baltimore (23,915), Carroll (10), Charles (1), Harford (78), Howard (58), Montgomery (3), Talbot (10), Prince George's (34), and Worcester (141) counties.

State Fiscal Effect: General fund expenditures increase by \$472,500 in fiscal 2013 and \$50,000 in subsequent years to account for the bill's requirements that SDAT prepare a Deed of Redemption for each redeemed ground lease. Currently, SDAT only issues a certificate of redemption. To meet the legal requirements of a deed, SDAT may need to hire a contractor to perform a title search and write the deed. SDAT advises that the cost of preparing each deed is \$500.

As noted above, SDAT issued 1,160 extinguishment certificates to tenants of the ground lease holders who had not registered. SDAT expects at least 75%, or 870, of the tenants that received an extinguishment certificate will apply for redemption. It is expected that

most tenants issued extinguishment certificates will apply for redemption within fiscal 2013. Additionally, SDAT receives approximately 100 redemption applications a year. If SDAT issues 945 Deeds of Redemption in fiscal 2013, to account for the bill's October 1, 2012 effective date, and 100 each subsequent year, general fund expenditures increase by \$472,500 in fiscal 2013 and \$50,000 in subsequent years.

Created by Chapter 327 of 1991, the Circuit Court Real Property Records Improvement Fund consists of surcharges assessed on instruments recorded in the land records and the financing statement records, document copying revenues, and accumulated interest revenue. The nonlapsing fund supports all personnel and operating costs within the land records offices of the clerks of the circuit court. It further supports the maintenance costs of the Electronic Land Records Online Imagery System and its website for making images accessible to the public. The Budget Reconciliation and Financing Act of 2011 (Chapter 397) increased the surcharge on all recordable instruments that supports the fund, from \$20 to \$40, for fiscal 2012 through 2015.

Special fund revenues increase for the Circuit Court Real Property Records Improvement Fund to account for the bill's requirement to record a Deed of Redemption in a circuit court. As noted above, SDAT expects to issue approximately 945 deeds in fiscal 2013 and 100 each subsequent year. Based on this estimate, special fund revenues increase by \$37,800 in fiscal 2013 and \$4,000 in subsequent years.

Finally, general fund revenues increase by \$9,450 in fiscal 2013 and \$1,000 in subsequent years to account for the bill's requirement to record a Deed of Redemption in a circuit court. As noted above, SDAT expects to issue approximately 945 deeds in fiscal 2013 and 100 each subsequent year. Under the bill, the recordation fee for a Deed of Redemption is \$10.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Baltimore City, Office of the Attorney General (Consumer Protection Division), Judiciary (Administrative Office of the Courts), Department of Legislative Services

Fiscal Note History: First Reader - March 7, 2012
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Analysis by: Michael F. Bender

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