

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

Senate Bill 135

(Senators Gladden and Frosh)

Judicial Proceedings

Environmental Matters

Ground Leases - Registration - Failure to Register

This bill requires a holder of a ground lease to comply with an existing requirement to register with the State Department of Assessments and Taxation (SDAT) before the holder may (1) collect any ground rent payments due under the ground lease; (2) bring a civil action against the leasehold tenant to enforce any rights the ground lease holder may have under the ground lease; or (3) obtain a lien on the property. The bill also repeals provisions relating to the extinguishment of a ground lease not registered with SDAT prior to September 30, 2010, and voids any extinguishment certificates issued by SDAT for failure to register.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: The bill's requirements can be absorbed within existing budgeted resources.

Local Effect: Any increase in expenditures due to the filing in county land record offices is expected to be minimal. No impact on revenues.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill does not prohibit a ground lease holder who registers a ground lease from collecting ground rent payments or taking any other enforcement actions after the ground lease is registered. Additionally, before a holder can collect any yearly or half-yearly ground rent installment payment or obtain a lien, the holder must mail, at least

60 days before the payment is due, a bill for the amount owed to the leasehold tenant's last known address and the address of the property subject to the ground lease. The bill alters the contents of a notice that must be sent with the bill to include information regarding the required registration of the ground lease. On request of the ground lease holder or the leasehold tenant, SDAT is required to file a notice with any extinguishment certificate filed in county land records stating that the certificate is void and the underlying leasehold interest is in full effect unless otherwise redeemed.

Current Law/Background: The bill is in response to the Court of Appeals decision in *Muskin v. State Dept. of Assessments and Taxation* 422 Md. 544 (2011) which held that the extinguishment of a ground lease for failure to register is unconstitutional.

Ground Rent System in Maryland: 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 has agreed 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 ejectment 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.

State Ground Rent System Challenged: A series of *Baltimore Sun* articles in 2006 noted a sharp increase in the number of ejectment actions due to ground leases. In 2007, the General Assembly enacted 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 ejectment 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.

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.

Vested Property Rights Upheld: 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 law's flaws 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 case in the Circuit Court for Anne Arundel County, *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.

Additional Information

Prior Introductions: None.

Cross File: HB 177 (Delegates McIntosh, *et al.*) – Environmental Matters.

Information Source(s): State Department of Assessments and Taxation, Baltimore City, Baltimore County, Judiciary (Administrative Office of the Courts), Department of Legislative Services

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