

Department of Legislative Services
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FISCAL AND POLICY NOTE

Senate Bill 366

(Senator Jones-Rodwell, *et al.*) (By Request - Baltimore
City Administration)

Judicial Proceedings

Environmental Matters

Baltimore City - Extinguishment or Redemption of Ground Rents

This bill repeals the requirement that Baltimore City must condemn property before it may apply to the State Department of Assessments and Taxation (SDAT) to extinguish or redeem a ground rent on the property. The bill authorizes the city to apply to SDAT to extinguish or redeem a ground rent on property acquired by the city by any means. The bill alters the content of an affidavit that the city must file with SDAT to extinguish or redeem a ground rent on property that was acquired or is being acquired by the city by certifying that the landlord has not registered the ground lease with SDAT. The bill also authorizes a landlord of property acquired by the city whose ground rent has been redeemed to collect a redemption amount.

Fiscal Summary

State Effect: The bill does not materially affect State governmental operations or finances.

Local Effect: Significant decrease in Baltimore City expenditures in FY 2014 and subsequent years due to the streamlining of the process required to be undertaken for the city to extinguish or redeem a ground rent. No impact on revenues.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill repeals the requirement that an affidavit required to be filed with SDAT to extinguish or redeem the ground rent on property certify that (1) the property was acquired or is being acquired through condemnation; (2) a thorough title

search has been conducted; and (3) that the landlord of the property cannot be located or identified.

Current Law/Background:

Ground Rent, Generally: 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 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.

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 passed seven bills addressing ground leases. One of these bills, Chapter 286 of 2007 (HB 452), altered the remedy for nonpayment of ground rent on residential property. Chapter 286

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.

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 288, 289 (SB 398/HB 502), and 291 (HB 489) 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 30-day'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 Chapters 288 and 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. Additional information is found below on the process by which Baltimore City may redeem a ground rent through this alternative method.

Furthermore, Chapter 290 of 2007 (HB 580) 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. Chapters 464 and 465 of 2012 (SB 135/HB 177) repealed authority for the extinguishment of the reversionary interest of a ground lease holder for failure to register a ground lease with SDAT prior to the September 30, 2010 deadline. Any extinguishment certificates issued by SDAT were voided.

As of January 2013, there were 87,441 ground leases registered with SDAT. Ground rents are concentrated mostly in Baltimore City as the city has close to 60,000 registered ground rents.

Baltimore City Ground Rent Procedures

Upon the condemnation of property that is subject to an irredeemable ground rent by Baltimore City, the city becomes tenant of the ground rent and must provide the specified notice to the landlord and apply to SDAT in the identical fashion as other ground rent tenants to extinguish the ground rent. Baltimore City advises that condemnation of ground rent takes from 12 to 18 months. Additionally, if the city condemns abandoned or distressed property that is subject to a redeemable ground rent, the city may redeem the ground rent by an identical process.

Once SDAT has posted a required notice on its website for 90 days, the city must provide up to three years' back rent and an affidavit certifying that:

- the property is abandoned or distressed property as defined by the Public Local Laws of Baltimore City;
- the property was acquired or is being acquired by the city;
- a thorough title search has been conducted;
- the landlord of the property cannot be located or identified; and
- the existence of the ground rent is an impediment to redevelopment of the site.

SDAT must issue a ground rent extinguishment certificate or redemption certificate, as appropriate, upon the receipt of the payment and affidavit. A landlord whose ground rent has been extinguished or redeemed may file a claim with the Baltimore City Director of Finance to collect the annual rent or redemption amount, respectively.

Local Fiscal Effect: Baltimore City expenditures decrease significantly in fiscal 2014 and subsequent years due to the streamlining of the process required to be undertaken for the city to extinguish or redeem a ground rent. Currently, the city holds 3,500 properties subject to ground rents, the majority of which were acquired through means other than condemnation. Additionally, the city holds approximately 1,200 tax sale certificates for leasehold interests in property that are also subject to ground rent. The city advises that it acquires approximately 250 additional properties a year, many of which are subject to a ground rent. The redemption of ground rents is required because the private development market requires a clean fee-simple title as a prerequisite to capital investment in an urban development project.

Under current law, Baltimore City may only use SDAT's ground rent redemption process for properties that have been acquired by condemnation. As noted above, the majority of properties subject to ground rents that are owned by the city are acquired by means other than condemnation. To redeem the ground rents for property acquired by other means, the city must first process a condemnation. While SDAT's ground rent redemption

process takes an average of 180 days and costs a minimal amount, the condemnation process, for Baltimore City, as noted above, takes 12 to 18 months and costs at least \$1,500 in legal and administrative expenses.

The city estimates that, under the bill, expenditures may decrease by \$7 million to \$10 million for the processing of ground rent redemption for its *current* inventory. The city further estimates annual savings of \$375,000 to \$500,000 for each subsequent year, assuming acquisition of at least 250 properties annually.

Additional Information

Prior Introductions: None.

Cross File: HB 521 (Delegate Anderson)(By Request - Baltimore City Administration) - Environmental Matters.

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

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