

Department of Legislative Services
Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

House Bill 511 (Delegate Holmes)
Environment and Transportation

Real Property - Residential Property - Ground Leases

This bill substantially reorganizes the law related to ground leases applicable to residential property and makes multiple additions. The bill repeals a provision of law that makes the establishment of a lien the remedy for nonpayment of a ground rent on residential property and reinstates, with modifications, an action to re-enter as the remedy, similar to the posture of the law before 2007. The bill also prohibits the holder of a ground lease from bringing an action against a tenant unless the ground lease is registered, prohibits the use of self-help to take possession of residential property, and allows for a holder of a security interest in a property subject to a ground lease to apply to redeem the reversion. In addition, in an ejectment action, the bill specifies and places limits on the expenses for which a ground lease holder may be reimbursed and adds new requirements for notice and service of process on a leasehold tenant.

The bill takes effect June 1, 2015.

Fiscal Summary

State Effect: Neither the change to the remedy available for failure to pay ground rent, nor the additional protections provided to tenants, materially affect the finances or operations of the Judiciary. Minimal increase in special fund revenues due to additional fees paid to redeem ground leases. To the extent that leasehold tenants and secured parties attempt to redeem ground leases attached to specified properties, special fund expenditures increase minimally for the State Department of Assessments and Taxations (SDAT) to handle the additional workload.

Local Effect: Neither the change to the remedy available for failure to pay ground rent, nor the additional protections provided to tenants, materially affect the finances or operations of the circuit courts or those local jurisdictions that hold ground rents.

Small Business Effect: Potential meaningful. The bill may result in additional income for small businesses that are ground lease holders from additional redemptions, which may be partially offset due to caps on certain expenses that may be recovered. Conversely, the higher bar for right of re-entry may result in reduced revenues due to fewer acquisitions of property.

Analysis

Bill Summary: The bill's provisions do not apply to business or commercial property, multifamily buildings that exceed four units, or mobile home parks.

Action to Re-enter

The bill repeals the lien remedy for nonpayment of ground rent that was established in 2007 and restores the pre-2007 remedy by establishing an "action to re-enter," with modifications. For a ground lease in effect on or after July 1, 2007, a ground lease holder may bring an action to re-enter only if (1) the ground lease holder has the lawful right to re-enter for nonpayment; (2) the ground lease is registered; (3) the payment of ground rent is at least six months delinquent; and (4) the ground lease holder complies with notice and other procedural requirements as specified. The bill also specifies the circumstances under which a leasehold tenant may cure a ground lease default, generally by paying, in addition to the delinquent ground rent, reasonable late fees and collection costs, as specified.

When a leasehold tenant under a ground lease fails to pay rent, the ground lease holder may bring an action to re-enter the property. The bill also requires ground lease holders to send notice, no less than 60 and 30 days before filing an action to re-enter, containing specified information in the form required by the bill to the leasehold tenant. If a secured party has an interest in property subject to a ground lease, the bill specifies that the secured party must be notified regarding the requirement to pay ground rent. The secured party is authorized to cure the default by paying the delinquent rent as well as any interest, fees, and collection costs as authorized by the bill. The notices must include statements that the holder of the secured interest may pay the late rent and additional fees, as well as redeem the property. Within six months after a judgment for possession in favor of the ground lease holder, the tenant or any other person claiming under the ground lease may pay the past-due ground rent and any late fees, interest, or collection costs authorized and then commence a proceeding to obtain relief from the judgment.

Personal service of process in an action filed against a tenant, or the holder of a secured interest in the property, must be made in accordance with the Maryland Rules.

Reimbursement of Costs and Expenses

Generally, a ground lease holder may not receive reimbursement for any additional costs or expenses related to collection of the past-due ground rent unless all notice and procedural requirements are met.

At least 60 days before filing an action to re-enter, the ground lease holder must send a notice to the leasehold tenant's last known address following the procedures specified in the bill. If authorized under the ground lease, a ground lease holder may be reimbursed for reasonable late fees, interest, and collection costs (up to \$100), provided the outstanding amount due is paid in response to the notice sent.

If the leasehold tenant does not remit the required payment, after the first notice has been sent, then at least 30 days before filing an action to re-enter, the ground lease holder must send another notice to the leasehold tenant's last known address. If authorized under the ground lease, a ground lease holder may be reimbursed for reasonable late fees, interest, and collection costs (up to \$650), including title and abstract and examination fees, judgment report costs, photocopying and postage fees, and attorney's fees.

If the leasehold tenant does not remit the required payment, then the ground lease holder may file an action in circuit court to re-enter no sooner than 30 days after the second notice is sent. If authorized under the ground lease, a ground lease holder may be reimbursed for reasonable late fees, interest, and collection costs, including filing fees and court costs, expenses incurred in the service of process or otherwise providing notice, reasonable attorney's fees (up to \$500), and taxes, including interest and penalties, that have been paid by the ground lease holder or plaintiff.

Additional Protections for Leasehold Tenants

The bill also enacts additional protections for leasehold tenants, similar to the posture of the law before 2007, with some additions and modifications.

Prohibition Against Nonjudicial Eviction: The bill adds ground lease holders to a law that prohibits a party claiming the right to possession from taking possession or threatening to take possession of residential property from a protected resident by (1) locking the resident out of the residential property; (2) engaging in willful diminution of services to the protected resident; or (3) taking any other action that deprives the protected resident of actual possession.

Redemption of Ground Lease Secured by Party: If the leasehold tenant is in default under a security instrument, then the holder of the secured interest in a property that is subject to a ground lease may apply to SDAT to redeem the reversion. If a holder of a secured interest

applies to redeem a reversion, the secured party must pay to the ground lease holder the outstanding amount due, including late fees, interest, and collection costs.

Enhanced Notices to Leasehold Tenants: The bill expands the content of notices required to be included in ground rent bills and contracts for the sale of residential property subject to a ground lease. The notices must include specified information stating that (1) if a ground lease holder files an action in court to collect past-due ground rent, the leasehold tenant may be required to pay the ground lease holder for fees and costs associated with the collection of the past-due ground rent; (2) the ground lease holder may file an action in court to take possession of the property, which may result in the leasehold tenant being responsible for additional fees and costs; and (3) there are limits on how much a ground lease holder may be reimbursed for fees and costs. The bill also requires the formula for calculating the redemption amount, as well as a statement of the redemption amount, to be included in the notices.

Reorganization of Laws Concerning Ground Leases on Residential Property

The bill also creates a new subtitle in the Real Property Article that contains most laws concerning ground leases on residential property. The bill reorganizes and recodifies these laws in the new subtitle and makes mainly nonsubstantive changes to those provisions, such as making terms consistent.

Current Law/Background: Elements of this bill are a response to the Maryland Court of Appeals decision in *State v. Goldberg, et al.*, 437 Md. 191 (2014), which held that provisions of Chapter 286 of 2007 eliminating ejectment as a remedy for nonpayment of ground rent and replacing it with a process to create and foreclose on a lien were unconstitutional. This bill substantially restores the ejectment remedy available for ground lease holders of residential property available prior to 2007. “Residential property” means property used, or intended to be used, for four or fewer dwelling units.

Ground Leases, Generally

As of February 2015, there were 88,422 ground leases registered with SDAT. Ground leases are concentrated mostly in Baltimore City (59,955), with some properties located in Anne Arundel (3,539), Baltimore (24,506), Carroll (10), Charles (1), Harford (171), Howard (58), Montgomery (3), Prince George’s (36), and Worcester (143) counties.

History of Ground Leases in Maryland: Ground leases have been a form of property holding in Maryland since colonial times. A ground lease creates a leasehold estate in the grantee that is personal – not real – property. The grantor retains a reversion in the ground lease property and fee simple title to the land. Ground leases generally have a 99-year term and are renewable 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. 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. Because the tenant had a leasehold estate, a tenant whose property was seized in an ejectment action received no other compensation.

2007 Ground Lease Legislation: In December 2006, a series of articles in the *Baltimore Sun* described an apparently dysfunctional ground rent system in which residential property was being seized over missed ground rent payments and homeowners were being charged exorbitant fees. Often, because of the age of the ground rent, it was reported that the occupant of the property did not know of the existence of the ground rent until facing ejectment or other legal action.

Several measures in the 2007 session addressed the ground rent system. Chapter 1 of 2007 prohibited the creation of new residential ground rents on or after January 22, 2007. The other measures dealt with existing ground leases on residential property.

To eliminate the possibility that a leasehold tenant could lose the tenant's home and all of the equity in it for failure to pay a ground rent, Chapter 286 of 2007 repealed the ability of a ground lease holder to bring an action of ejectment for failure to pay ground rent and instead provided for the creation of a lien.

Chapter 290 of 2007 facilitated the timely payment of ground rents by requiring SDAT to establish an online registry of properties subject to a ground rent. The bill required ground lease holders to register their properties by September 30, 2010. If a ground lease holder failed to register by that date, the ground lease holder's reversionary interest would be extinguished and the ground rent was no longer payable.

Chapters 288 and 289 of 2007 required a ground lease holder to mail a bill to the leasehold tenant's last known address no later than 60 days before an installment payment is due. The bill must include specified information about the property, contact information for the ground lease holder, consequences for failing to pay the ground rent, and the right to redeem the ground rent. A contract for the sale of real property subject to a ground rent must include similar information.

Finally, Chapters 287 and 291 of 2007 encouraged leasehold tenants to redeem ground rents and gain fee simple title to the land underneath their homes. Chapter 287 provided for the conversion of irredeemable ground rents (that is, those executed before April 9, 1884) to redeemable ground rents. An irredeemable ground rent became converted to a redeemable ground rent unless a notice of intention to preserve irredeemability was recorded in the land records by December 31, 2010. If notice was filed, then the

irredeemability continues through 2020 unless another 10-year notice is filed. Once a notice lapses, the ground rent becomes redeemable. Chapter 291 eliminated the statutory waiting period before a leasehold tenant may redeem a ground rent and established notice requirements about the right to redeem when a ground rent is transferred to a third party.

Constitutionality of Chapter 290 of 2007

In 2011, the Maryland Court of Appeals held that the retrospective extinguishment and transfer provisions of Chapter 290 violated the due process and takings provisions under Maryland's Declaration of Rights and Constitution and were, therefore, unconstitutional. *Muskin v. State Dept. of Assessments and Taxation*, 422 Md. 544 (2011). However, the court held that the registration requirement was valid. 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. 442 Md. at 550.

In response to the holding in *Muskin*, Chapters 464 and 465 of 2012 require a holder of a ground lease to comply with the existing requirement to register with 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 measures do not prohibit a ground lease holder who registers a ground lease from collecting up to three years of back ground rent payments or taking any other enforcement actions after the ground lease is registered. 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 measures also repealed provisions relating to the extinguishment of a ground lease not registered with SDAT prior to September 30, 2010, and voided any extinguishment certificates issued by SDAT for failure to register. On request of the ground lease holder or the leasehold tenant, SDAT is required to file a notice in the county land records where an extinguishment certificate was filed stating that the certificate is void and the underlying leasehold interest is in full effect unless otherwise redeemed.

Constitutionality of Chapter 286 of 2007

In *Goldberg*, the plaintiffs claimed that the retroactive elimination of the remedy of ejectment amounts to a taking of private property without just compensation. The Maryland Court of Appeals, citing *Muskin* as governing the outcome, agreed with the plaintiffs that the provisions of Chapter 286 were unconstitutional under the Maryland Declaration of Rights and the Maryland Constitution.

The court reasoned that within a statement in the *Muskin* opinion – that “[a] ground lease creates a bundle of vested rights for the ground rent owner, [1] a contractual right to receive ground rents and [2] the reversionary interest to re-enter the property in the event of a default or if the leaseholder fails to renew” – the “reversionary interest” actually collectively includes two distinct, intertwined rights: the reversion and the right to re-entry. *Goldberg* at 18, quoting *Muskin* at 559. According to the court, the right of re-entry is the right to pursue a provided remedy, such as ejectment, to terminate the leasehold interest and recover rents due prior to the termination, and the foreclosure-and-lien remedy is not an adequate replacement. *Goldberg* at 22 and 23. The court further explained that “[d]ue to the unique nature of the property rights invested in ground rent leases, where the ground leaseholder’s rights are bundled, the right of re-entry is vested.” *Goldberg* at 26. Thus, the court, stating that “the ejectment remedy ... is essential for the right of re-entry,” ruled that Chapter 286’s impingement of the vested right is unconstitutional. *Goldberg* at 25 and 26.

2014 Legislative Proposal

Similar to this bill, Senate Bill 1095 and House Bill 1529 of 2014 were responses to the Maryland Court of Appeals decision in *Goldberg*, proposing to restore the ejectment remedy available for ground lease holders of residential property available prior to 2007. Among other specified alterations to the laws governing ground leases, the bills would have repealed a provision of law that made the establishment of a lien the remedy for nonpayment of a ground lease on residential property and reinstated, with modifications, an action for possession of the property (an ejectment action) as the remedy. This would have created a statutory regime similar to the posture of the law before 2007.

State Fiscal Effect: Special fund revenues increase minimally due to additional fees from ground lease redemption applications. Special fund expenditures increase minimally to process ground lease redemption applications. To the extent that leasehold tenants and holders of a secured interest in property that is subject to a ground lease seek to redeem the reversion, SDAT experiences an increase in applications. Each application requires SDAT to coordinate communications and the ultimate settlement between the secured party and the holder of a ground lease. The office within SDAT that facilitates redemptions of specified ground leases is funded through the SDAT special fund. Thus, any increase in workload results in increased special fund revenues and expenditures.

Additional Information

Prior Introductions: A similar bill, SB 1095, passed both the Senate and the House with amendments. The Senate refused to concur with the House amendments, and the bill was sent to conference committee where no agreement was reached. Its cross file, HB 1529 of 2014, received a hearing in the House Environmental Matters Committee, but no further action was taken.

Cross File: None.

Information Source(s): Anne Arundel, Baltimore, Charles, Carroll, Harford, Howard, Talbot, and Worcester counties; Baltimore City; State Department of Assessments and Taxation; Office of the Attorney General; Judiciary (Administrative Office of the Courts); *Baltimore Sun*; Department of Legislative Services

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