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plies if there is a surviving parent of the decedent. But, if there is surviving minor issue, the spouse will receive only one half of the estate, the other half of the estate going to the surviving minor issue. The policy is to prevent minor issue from possibly becoming wards of the state by insuring their support. Md. Est. & Trust Code Ann. § 3-102 (1982).

Proponents of the amendment were hoping that the legislature would adopt the Uniform Probate Code § 2-102 (1969), which gives the surviving spouse the first \$50,000 of the estate plus one half of the residue, however, the Maryland legislature was not ready for such a drastic change. The steady progression of this law from 1974 to 1982 indicates that it may not be long before the Uniform Probate Code finds its way into Maryland Law.

Louis J. Rosenthal, member of the Governor's Committee on Intestate Succession and a member of the adjunct law faculty of the University of Baltimore School of Law supplied information regarding this recent amendment.

Legislative— New Incentive for Secondary Financing?

by Lisa Dopkin

With housing starts at record lows, high interest rates, and the Supreme Court's recent ruling upholding the validity of "due-on-sale" clauses in mortgages by federally chartered institutions, it seems as if the American dream of buying a home is beyond the reach of most. In order to aid the troubled housing market in times such as these, it is often necessary to develop alternative methods of financing.

The Maryland legislature recently amended Section 8-110 of the Real Property Article, increasing from 6% to 12% the allowable capitalization

rate for redemption of certain reversionary estates created by "ground rent" leases for longer than 15 years. This action provides a much needed incentive for creating secondary financing.

Historical Background

"Ground rent" leases, while not generally used in other states, have been used in Maryland, particularly in Baltimore City, since the colonial days. The origin and development of ground rents in this state have been extensively reviewed by Judge Frank A. Kaufman; *The Maryland Ground Rent—Mysterious But Beneficial*, 5 Md. L. Rev. 1 (1940) and by Mayer, *Ground Rents in Maryland* (1883).

In the ground rent lease, the owner of the land in fee simple leases it for the period of 99 years with a covenant for renewal from time to time forever upon payment of a small renewal fine. The renewal is conditioned on the lessee paying a certain rent (usually payable semi-annually), which, if capitalized at a reasonable rate of interest, represents what is conceived to be the value of the land. The lease also usually provides that if the payment is in default the lessor may re-enter and terminate the lease. This system of creating leasehold estates appears to have been based on the policy of encouraging the lessee to make improvements. *Banks v. Has-kie*, 45 Md. 207 (1876); *Culbreth v. Smith*, 69 Md. 450, 16 A. 112 (1888); *Moran v. Hammersla*, 188 Md. 378, 52 A.2d 727 (1947); *Kolker v. Biggs*, 203 Md. 137, 99 A.2d 743 (1953). Although the term "ground rent" primarily relates to the rent payable to the lessor, it is often used to refer to the lessor's reversionary interest in the leasehold premises. *Ogle v. Reynolds*, 75 Md. 145, 23 A. 137 (1891).

The interest of the owner of the reversion has long been held to be an interest in real property. On the other hand, the interest of the lessee is a leasehold interest, and has been uniformly regarded as per-

sonal property, notwithstanding the fact assignment of the leasehold interest must be executed, acknowledged and recorded as deeds. *Myers v. Silljacks*, 58 Md. 319 (1882).

However, "[u]nlike ordinary leases . . . the leasehold interest is frequently, not to say usually, by far the most valuable of the two interests in such perpetual leases . . . The leaseholder is the substantial owner of the property. All that the owner of the ground rent is concerned about is that his rent is secure . . ." *Mayor and City Council of Baltimore v. Latrobe*, 101 Md. 621, 640, 61 A. 203, 209 (1905).

"In practical economic effect, the relation of the lessee to the property is that of an owner of land and improvements thereon subject to the payment of the annual rent and taxes on the property . . . [t]he technical relation between the owner of the rent and of the leasehold is that of landlord and tenant." *Jones v. Magruder*, 42 F. Supp. 193, 196 (D. Md. 1941). Furthermore, the owner of the leasehold under ground rent lease may assign, sublet or mortgage the leasehold. *Williams v. Safe Deposit & Trust Co.*, 167 Md. 499, 175 A. 331 (1934).

For more than a century the leasehold owner could not absolve himself of the necessity of paying the rent absent an appropriate provision in the lease. However, beginning in 1884, with a series of statutes which were only prospective in their operation, the legislature provided for the conditions upon which the ground rents were made redeemable at the option of the leasehold owner. *Trustees of Sheppard & Enoch Pratt Hospital v. Swift & Co.*, 178 Md. 200, 13 A.2d 174 (1940). Redemption transferred the fee to the leasehold owner thus relieving him of the obligation to pay rent. The redemption statutes apply not only to the usual form of ground rent leases for 99 years, renewable forever, but also to all leases of terms in excess of 15 years. *Marburg v. Mercantile Bldg. Co.*, 154 Md. 438, 140 A. 836 (1928). But redemption could not, and to this day cannot,

be exacted by the owner of the reversion. 1884 Md. Laws ch. 485, now codified Md. Real Prop. Code Ann. § 8-110 (1974) (amended, 1982, ch. 317).

"A redeemable ground rent is in effect a mortgage without a due date—a mortgage whose principal need never be paid . . .," Kaufman, 5 Md. L. Rev. at 47. In *Mayor of Baltimore v. Canton*, 63 Md. 218, 237 (1885), the Court of Appeals said, "The landlord's interest in the land is but a form of money investment, analogous to that secured by a mortgage." Likewise, in *Jones*, it was stated "the lessee's relation to the owner of the ground rent is comparable to that of a mortgagor paying interest on a debt where the principal never matures so long as the mortgagor pays the interest and taxes." *Jones*, 42 F. Supp. at 196.

Despite the many similarities between redeemable ground rents and mortgages, the legal effect of a lease is not the same as that of a mortgage. A mortgage secures a debt of a specified sum, the mortgagor binding himself to pay at some definite future date. On the other hand, the leasehold owner purchases his estate upon the consideration of an annual rent, with the privilege of buying the reversion at the time and for the amount stipulated in the instrument or allowed by statute. In this respect, Section 8-110(b) provides in pertinent part:

If a lease was executed between April 8, 1884 and April 5, 1888, the redemption price may be some other sum specified in the lease not exceeding 4 percent capitalization of the reversion.

Section 8-110(c) provides:

If the lease is executed on or after July 1, 1971, the reversion is redeemable at the expiration of 3 years from the date of the lease. If the lease is executed on or after July 1, 1982 or between July 1, 1969 and July 1, 1971, the reversion is redeemable at the expiration of 5 years from the date of the lease. If

the lease is executed before July 1, 1969, the reversion is redeemable at any time.

If the lessee fails to pay the annual rent or the taxes, the reversioner can re-enter and take possession of the leasehold. *Heritage Realty, Inc. v. Mayor and City Council of Baltimore*, 252 Md. 1, 248 A.2d 898 (1968). However, the lessee has no obligation to buy the reversion, and the lessor has no grounds for complaint—the parties do not stand in a debtor-creditor relationship except as to the payment of the stipulated rent. *Packard v. Corporation for Relief of Widows and Children of Clergy of Protestant Episcopal Church in Maryland*, 77 Md. 240, 26 A. 411 (1893).

It is in the context of this historical background that the recent amendments to the Real Property Article, Section 8-110 must be viewed. However, Section 8-110 does not apply to leases of other than primarily residential property or to irredeemable leases executed before April 9, 1884. With the exception of apartment and cooperative leases, the allowable rate for leases created after July 1, 1982 was raised from 6% to 12% in a presumed effort to encourage the creation of "ground rent" leases. The amendment will remain in effect until June 30, 1984 at which time it will be automatically abrogated as mandated in the statute.

As a means of demonstrating the effect of the amendments, assume the selling price of a home is \$50,000 and the seller creates a \$240 yearly ground rent. Formerly, developers would create a "ground rent" lease as a sales incentive, theoretically reducing the sales price by the value of the ground rent. Thus with the previous 6% rate, the capitalized value of the reversionary interest would be \$240 divided by 6% or \$4000, and the buyer's initial purchase payment would be theoretically reduced to \$46,000. However, with interest rates greatly exceeding the allowable 6% rate, most developers ceased to create "ground rent" leases.

Accordingly, the legislative purpose for raising the allowable capitalization rate to 12% appears to be to promote the sales of homes, by making additional financing available to the prospective home buyer, as a result of increasing the likelihood that ground rent leases will be created. With the new 12% rate in effect, the capitalized value of the reversionary interest is \$240 divided by 12% or \$2,000, theoretically reducing the initial purchase payment to only \$48,000.

While in both instances the owner of the ground rent would be receiving the same \$240 a year, the lessor (investor) being able to use the new 12% rate will clearly benefit more, as evidenced by the amount of his initial investment—\$2,000 vs. \$4,000. Furthermore, the comparison of the benefit to the buyer in regard to the theoretical reduction of the initial purchase payment will be \$2,000 vs. \$0, since new "ground rent" leases were rarely being created at the previous 6% rate.

Granted, \$2,000 does not seem like a great deal of money when one is considering the purchase of a home priced at \$50,000. However, it must be remembered, we are talking only about secondary financing, and in these tough economic times any additional financing available to the buyer can be viewed as a benefit.

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