LEGISLATIVE SUPPLEMENT

PIT FALLS IN TEXAS HOME EQUITY LENDING

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FOR PRESENTATION TO:

1999 HOME EQUITY LENDING WORKSHOP
TEXAS MORTGAGE BANKERS ASSOCIATION
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SUBJECT: 76th Texas Legislature Votes to Expand Constitutional Urban Homestead Exemption Against Forced Sale to 10 Acres and to Better Define Distinction Between Urban and Rural Homesteads

Pleas for a legislative fix to the uncertainties in the meaning and application of such Section 50(a)(6) conditions as the *three percent fee cap* and *additional collateral* prohibitions were heeded in part when the 76th Legislature passed S.B. 496 and its companion joint resolution, S.J.R. 22, which were signed into law by Governor Bush on June 19, 1999. These bills address the pitfalls inherent in the Section 50(a)(6)(H) prohibitions against additional collateral when a lender attempts to secure an equity lien on purported urban homestead property that in fact exceeds one acre in area, as discussed in your materials beginning on page 12.

OVERVIEW: S.B. 496

Section 1 of S.B. 496 (Harris) would amend Section 41.002(a) of the Property Code to define a homestead, when used for the purposes of an urban home ***or both*** an urban home and a place to exercise a calling or business (i.e., a business homestead), as consisting of ***not more than 10 acres*** of land, which may be in one or more ***contiguous*** *lots*, together with improvements thereon. When the urban home is part of one or more contiguous lots containing a total of more than 10 acres, Section 3 of the bill would amend Section 41.005 of the Property Code to authorize a homestead claimant to ***voluntarily designate*** not more than 10 acres of the property as *homestead*. These amendments take effect January 1, 2000, ***if*** the constitutional amendment proposed by S.J.R. 22 is approved by the voters in a November, 1999, referendum.

Section 2 of S.B. 496 amends Section 41.002(c) of the Property Code to provide a *bright line test* for distinguishing between urban and rural homesteads when the character of the homestead property is ambiguous and the property has characteristics of each (see discussion in your materials under *b. The Ambiguous Suburban Homestead* beginning on page 14). Under this test, a homestead is considered *urban* if, at the time the designation of homestead is made, the property is:

- LOCATION: Located within the limits of a municipality, the extra territorial jurisdiction (ETJ) of a municipality, **or** a platted subdivision; **and**

- POLICE & FIRE PROTECTION: Served by police protection **(and)** paid or volunteer fire protection; **and**

- MUNICIPAL SERVICES: Served by **at least three** of the following services that are provided by a municipality or (another party) under contract to a municipality:
  - (i) Electric
  - (ii) Natural Gas
  - (iii) Sewer
  - (iv) Storm Sewer; and
  - (v) Water

Amended § 41.002(c) takes effect September 1, 1999, regardless of whether the constitutional amendment proposed by S.J.R. 22 is approved by the voters.

Section 5 of S.B. 496 amends §5.042 of the Property Code to abolish the common law doctrine or rule prohibiting an existing lien on part of a homestead from being extended to another part of the homestead not already charged with the debts secured by that existing lien. The amendment adding this common law rule to the junk heap with the earlier abolished Rule in Shelly's Case and the Doctrine of Worthier Title also takes effect September 1, 1999, regardless of whether the constitutional amendment proposed by S.J.R. 22 is approved by the voters.

COMMENT ON S.B. 496 AND S.J.R. 22

Assuming voter approval in November, these amendments to the Texas Constitution and the Property Code appear to have the legal effect as of January 1, 2000, of instantaneously expanding the boundaries of even existing urban homesteads to include all contiguous land to the home site, not exceeding 10 acres in area (when combined with the area of the preexisting homestead property), that is owned by the homestead claimant and used or intended to be used for purposes of an urban home (or both an urban home and a place to carry on a business or profession). Subsection (d) of § 41.002 of the Property Code in this regard provides that the definition of a homestead set forth in the section "applies to all homesteads in this state *whenever created"* (emphasis added). If the contiguous acreage used for these purposes exceeds 10 acres, the homestead claimant is then authorized to voluntarily designate a particular area not exceeding 10 acres (and necessarily containing the dwelling used as a home and related improvements) as *homestead*. Any urban homestead created on or after the January 1, 2000, effective date of the Property Code amendments, of course, is governed by the new law and has the benefit of the new homestead exemption of up to 10 acres, while the validity of any voluntary or involuntary lien on any urban homestead created before that effective date is governed by the law in effect on the date the lien was created and prior law is continued in effect for that purpose. (Similarly, any rights under a writ of execution against a homestead property issued before that January 1, 2000, effective date or rights under the statutory exemption from seizure of the sale proceeds of a homestead property sold before that effective date are governed by the law in effect at the time and prior law is continued in effect for that purpose.)

The expansion of the venerable Texas homestead to its new constitutional dimensions is enabled in part through the abolition of the common law rules prohibiting (i) the *spreading* of an existing homestead lien to other parts of the now expanded homestead boundaries not charged with the secured debt and (ii) the *overburdening* of the homestead when releasing an existing homestead lien as to only part of the homestead property or refinancing an existing homestead lien to include the now expanded homestead boundaries not subject to the lien. See the common law rule against *spreading* of a homestead lien espoused in *Baxter et al v. Crow et al*, 133 S. W. 2d 187 (Tex. Civ. App. – San Antonio 1939 Dism. Judgm. Cor.), which cited *Hayes v. First Trust Joint Stock Land Bank*, 111 S. W. 2d 1172 (Tex. Civ. App. – Ft. Worth 1939 Dism.) as authority for the established rule that an existing lien upon a part of the homestead may not be spread over another part not charged with the debt secured. See also the similar rule against *overburdening* the homestead (e.g., when an existing lien against a homestead is released or refinanced against a part of the homestead property and can be said to *overburden* the part of the homestead that is not released or that was not previously subject to the lien) set forth in *John Hancock Mutual Life Insurance Company v. Glascow*, 141 S. W. 2d 942 (Tex. Com. App. 1940).

New § 41.002(c) of the Property Code effective September 1, 1999, appears to provide a *bright line* test for determining if ambiguous suburban property claimed as homestead is *urban* in character. Presumably,

any claimed homestead property failing to meet this objective test as *urban* would be deemed *rural*. But this attempt by the legislature to better define the distinction between an *urban* and a *rural* homestead would appear to be subject to the same criticism of the courts as set forth in *United States of America v. Blakeman,* 960 F. 2d. 502 (5th Cir. 1992) cited in your materials at page 15. In absence of a constitutional amendment establishing this definition as an exclusive test, the determination of the character of a homestead property in any case would seem to continue to be a question of fact lying in the exclusive province of the courts.

In the process of redefining the urban homestead, the concept of the so-called *business homestead* is significantly undermined. As amended, § 41.002(a) would restrict the business homestead to a "place to exercise a calling or business" located within the same lot, or a contiguous lot, as the urban home. The business homestead could only be created and exist within a contiguous 10 acres that is used for the purposes of both an urban home and a place to carry on a business. But current law allows the business homestead to be located on a separate, non-contiguous lot "in the same urban area" as that of the urban home (so long as collectively the lots do not exceed one acre in land), and there is some authority for recognizing the existence of a business homestead even if the homestead claimant has no residence in the city where the business homestead is located. See in that regard *Scarborough v. Homeowner's Loan Corp.*, 161 S. W. 2d 886 (Tex. Civ. App. – Amarillo, 1942 err. Ref. w.o.m.). Moreover, the absence of an expressed *grandfathering* provision in S.J.R. 22 to preserve existing business homesteads that are now situated on separate, non-contiguous lots from that of the urban home casts a cloud over their exemption status after the January 1, 2000, effective date of the legislation. While the validity of liens impressed upon these business homesteads is expressly preserved and governed by the law existing at the time of their creation, no similar expression of legislative intent is made in the bill that pre-existing but non-conforming business homesteads are to continue to be exempt from forced sale under Section 50, Art. XVI, of the Texas Constitution. Constitutional homestead amendments in the past have been held by the courts to be *retroactive* and to apply to all homesteads *whenever acquired*. See in that regard *Dallas Power and Light Company v. Loomis*, 672 S. W. 2d 309 (Tex. Civ. App. – Dallas, 1984) in which the court found retroactivity to be implicit in the 1983 and 1970 constitutional amendments. But it is unclear whether the courts would apply the amendments proposed by S.J.R. 22 retroactively in the case of non-conforming business homesteads if the effect is to deny claimants the benefit of homestead protections, or whether the courts instead may find an implied legislative intent to *grandfather* non-conforming (i.e., non-contiguous) business homesteads created before the January 1, 2000, effective date.

Finally, S.B. 496 would add § 41.008 to the Property Code in anticipation of a conflict between these new constitutional homestead amendments and any federal law that may impose an upper limit on the amount, including a monetary amount or acreage amount, of homestead property that a person may exempt from seizure. In the event of such a conflict of law, § 41.008 would provide that state law shall prevail … "to the extent allowed under federal law." While this first appears nonsensical, this language is apparently targeted at pending legislation overhauling the U. S. Bankruptcy Code that would impose monetary limitations on exempt property claimed by a debtor unless applicable state law provides by statute that these monetary limitations shall not apply to debtors within the state. The engrossed version of H. R. 833 (Gekas), which if enacted would be known as the Bankruptcy Reform Act of 1999, would limit the exemption of any interest in real or personal property that the debtor or a dependent of the debtor uses as a residence to $250,000, unless among other exceptions … "applicable State law provides by statute that such paragraph shall not apply to debtors" in that state.

Attachments:
App. 1: Enrolled Version – Bill Text 76(R) S. B. 496
App. 2: Enrolled Version – Bill Text 76 (R) S.J.R. 22

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