

**SUBJECT:** Allowing homestead encumbrances for owelties of partition and tax loans.

**COMMITTEE:** Financial Institutions — committee substitute recommended

**VOTE:** 9 ayes — Marchant, Carona, Elkins, Giddings, Grusendorf, Gutierrez, Hudson, Patterson, Romo

0 nays

**WITNESSES:** For — John F. Rothermel, III, Texas Land Title Association

Against — None

**BACKGROUND:** The Texas Constitution allows lenders to foreclose on a person's homestead only in limited circumstances. When a borrower fails to make required payments on a secured loan, the lender may file a lawsuit asking a court to seize the property pledged as loan security, have the property sold and give the lender the proceeds. Art. 16, sec. 50, of the Texas Constitution prohibits the forced sale of a borrower's homestead to repay debts, except for three specific situations:

- a debt for the purchase price;
- a debt to finance improvements;
- a debt for local property taxes or for federal taxes.

An owelty of partition can occur in divorce and probate situations. When a piece of property is owned jointly by two or more people, either because of community property or co-tenancy through inheritance, each person owns an undivided interest in the property. An undivided interest allows each person to own the whole property while sharing that ownership with the other owners. By comparison, a divided interest would give each person a specific portion of the property.

In divorce and probate situations, the owner of one part of the property (the acquiring party) may wish to purchase the other person's (the conveying party) interest in the property. For a divided interest, the acquiring party could seek financing from a bank for a purchase loan. However, because the acquiring party owns the other undivided interest in the property, if the bank were to foreclose on the other part of the property it would become a

co-tenant with the person it foreclosed against. Because of such an undesirable situation, before banks will lend the acquiring party the money to purchase the conveying party's interest in the property they often require the acquiring party to offer as security the interest to be conveyed *and* the acquiring party's interest as well. In other words, the bank requires all interests in the property to be used as security for a loan to purchase only partial interest in the property. This process is known as an owelty of partition.

Under current Texas law, an owelty of partition is not considered a loan for the purchase price of property because the acquiring party's interest is used as security on the loan.

Art. 16, sec. 50 of the Constitution allows the foreclosure of homestead property to pay a debt for local property taxes and federal taxes. In order to pay such taxes, homeowners may desire to borrow money for taxes from third parties (banks, etc.). Recent court decisions have held that such loans may not be secured by the borrower's homestead even though the homestead may be foreclosed upon if the taxes are not paid.

**DIGEST:** CSHB 2924 would amend the Texas Property Code to include an owelty of partition in the definition of purchase money. The definition of taxes on the property would also be amended to include refinances by third parties of ad valorem taxes or federal tax liens.

This bill would take effect on September 1, 1995.

**SUPPORTERS SAY:** CSHB 2924 is a common sense measure that relates to two specific and confusing elements of homestead law. It would allow owners of undivided interests in property to obtain a loan to purchase the other interest, and it allows homeowners to take out a loan to pay their taxes instead of having the government foreclose on their property for failing to pay taxes. These measures would not affect the constitutional homestead protection, but would merely extend the definitions of what is not included in the protection in two rational and necessary ways.

The owelty of partition represents a unique contradiction in Texas law. The homestead protection (Constitution, Art. 16, sec. 50) allows a person's homestead to be used as security for a loan for the purchase price of the property. However, when the person already owns an undivided interest in the property and wishes to obtain a loan for the other interest, that person

cannot obtain a loan for the purchase because Texas law forbids them from using the interest they already own as security for the loan, and the lending institution will refuse to grant a loan when its interest is secured by less than the entire property. There is no reason to distinguish this situation from one in which the person is buying the whole property. When obtaining an owelty of partition, the owner of a property interest is really buying the whole property, in which they already own an interest.

A homestead is already subject to foreclosure for a purchase money loan. The bill would only revise the definition of a purchase to cover these narrow circumstances.

Homeowners with large property tax or federal tax bills are currently in a Catch-22 situation. If they do not pay their taxes, the governmental entity may foreclose upon their homestead. However, they cannot obtain a loan to pay those taxes using the homestead as security. In essence, the taxing authority is using their homestead as security on their taxes, but the owner of the property cannot do the same. The most used argument against allowing people to use their homestead as security on loans is that they could lose their homes if they fail to repay the loan. However, when tax loans are concerned homeowners could lose their homes anyway if they fail to pay their taxes.

**OPPONENTS  
SAY:**

This legislation could allow the Texas homestead protection to be sidestepped. The homestead exemption was intended to assure debtors and their families of a home and some means of support. Yet this legislation would expand the possibilities for lenders to take away a person's home.

**NOTES:**

The committee substitute to HB 2924 deletes an amendment to the definition of rural homestead in the original version that would have defined a rural homestead as not within the corporate limits of an incorporated city.