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Texas Law Offers Unique Protection There's No Place Like a Homestead

By Judon Fambrough

Bill collectors may knock on the door, but they cannot claim the door—or any other part of a homestead—to satisfy debts. Texas homeowners enjoy unique protection from creditors not provided by any other state. Homestead laws protect property from foreclosure and partitioning except in limited circumstances and form a basic part of the state's real property statutes.

The protection originated with the state's first constitution in 1840. The laws were considered necessary to offset economic dangers to Texans. Their purpose was to preserve the integrity of the family as a basic element of social organization, to encourage colonization, to provide debtors with a home for their families and some means of support so the family would not become a burden upon the public, and to retain the feeling of freedom and sense of independence necessary to preserve democratic institutions.

Homestead rights commence when the buyer obtains the right to possess the land, uses the property as a homestead and intends to claim the land as a home. Mere intent is insufficient; and usage, not occupancy, is required. The usage must indicate an intent to occupy the premises as a home. In the past, such acts as digging a water well or excavating and constructing a foundation or sidewalk have been held sufficient.

Initially only a family could claim homestead rights. A family legally exists whenever two or

more people live together under circumstances creating a moral or legal obligation for support. Under this definition, each spouse, following a divorce, can claim a separate homestead if each has a continuing legal obligation to support the children. However, Texas courts have not allowed an unmarried couple living together to claim a family homestead.

Recent changes in the law, though, allow single adults who are not members of a family to claim some land as a homestead.

A 1983 Texas constitutional amendment defined more clearly the maximum amount of property protected. Families in rural areas may claim the home and the surrounding acreage (whether contiguous or not) with all improvements for a total of 200 acres. Single adults may claim 100 acres.

Urban homeowners may claim the home and the surrounding lot or lots (whether contiguous or not) with improvements for a total of 10 acres. Qualifying single adults may claim the same amount. All or a part of the 10 acres may consist of business property. A business homestead can be a part of the urban homestead only if it is the place where the head of the family pursues his or her principal business.

For more information on business homesteads, see "Homestead Law Protects Businesses," publication 701.

What constitutes an urban environment is less than clear. In the past, case law has defined an urban area as a built-up area. Recent statutory language defines

an urban area as an area served by municipal utilities and fire and police protection.

For more information on when an area is considered urban and when it is considered rural, see "Homestead Protection: For Whom and How Much?" publication 1136. The publication also discusses when a single person can be considered head of a family for purposes of the amount of land claimed for homestead protection.

Creditors may make claims against acreage or lots in excess of the maximum area protected. If an excess exists, creditors may ask the head of the family (or single adult) to designate the exact acreage or lots. Designation relinquishes homestead rights on the undesignated portion.

Texas laws prevent creditors from taking homestead property except for:

- All or part of the purchase money for the homestead
- Delinquent property taxes on the homestead
- Work and material used in constructing improvements on the homestead
- An owelty lien resulting from a partitioning of the homestead or from an award of a family homestead in a divorce
- Refinancing a federal lien against the homestead.

On November 4, 1997, Texas voters approved a constitutional amendment that added two more circumstances when creditors may place a valid lien on the homestead. The first measure, known as home-equity loans, allows borrowers to use up to 80 percent of

their equity in homes as collateral. Prior to the constitutional change, Texas was the only state not allowing home equity lending. (See "Potential Pitfalls Face Texas Home Equity Lenders," publication 1252.)

The amendment also authorized another lending tool known as a Reverse Annuity Mortgage or RAM. RAMs are designed for homeowners over 55 who desire supplemental income. The older homeowner uses the home as collateral while still living in it. The lender makes monthly or periodic payments to the homeowner, and not vice versa, for the duration of the homeowners' life or some set period. The annuity payments are treated as loan advances rather than income; therefore, they are not subject to federal income tax. The loan is repaid in one lump sum with proceeds from the sale of the home when the borrower dies, sells the home or permanently moves out. (See "RAMS Attract Older Homeowners," publication 1212.)

In addition, the amendment implemented procedural changes for home improvement loans. After making a written loan application, homeowners must wait 12 days before executing the contract for work and materials. There also is a three-day right of rescission in which the borrower can withdraw from the executed contract without penalty. The contracts must be signed by both the owner and spouse at the offices of an attorney, a title company or the third-party lender extending credit. Details may be found in publication 1252 cited previously.

To receive protection from creditors, the property must be classified as a homestead prior to or at the time the loan or lien is created. Liens placed on property before becoming a homestead are valid and enforceable regardless of subsequent usage.

Surviving Spouse and Children

All family members who continue to occupy the home receive protection; therefore, homestead protection lasts throughout the marriage, during the life of the surviving widow or widower and extends to minor children during

their minority and to unmarried children. However, during the lifetime of a surviving parent, the children's homestead rights may be lost through the acts of the surviving parent. The children's right to claim the homestead arises only with the surviving parent's death.

For creditors to create a valid lien against the property when improvements are added, Texas laws require the contracts for labor and materials to be in writing and signed by both spouses *before* material is furnished or labor is performed. Furthermore, for the lien—sometimes referred to as a mechanic's lien—to be effective, it must contain a proper legal description of the property, the price to be paid for the labor and materials, the time of payment and a

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general description of the improvements. Also, it must be recorded in the county where the property is located.

As a general rule, once a homestead is established, it continues until lost by death, abandonment or sale.

Proving Abandonment

Death terminates the homestead only if the owner-occupant is not survived by family members who are entitled to continued protection under the law. These include the surviving spouse, minor and unmarried children.

The abandonment of a homestead is sometimes difficult to prove. Abandonment takes place when use is discontinued and there is no intent to use the property again as a home. Mere intent unaccompanied by actual discontinuance of use is not enough. Likewise, temporary absence, such as renting another home for a short while, is insufficient.

The issue of abandonment is always a question of fact. In cases of doubt, however, the burden of proof lies with the creditor.

And finally, a bona fide sale of the property terminates the homestead. A bona fide sale occurs when a purchaser pays consideration for the property without notice of a homestead claim. The conveyance must have the signature of both spouses even if the homestead is separate, not community property.

Pretended sales of the homestead are void. A homeowner cannot transfer the property to a third party (sometimes called a "straw party") and then back to the original owner to create a mortgage on the homestead otherwise forbidden by law.

Homestead rights cannot be waived to create an otherwise invalid lien. Texas courts have held consistently that homestead rights cannot be waived because they are constitutionally vested. The lien holder is given the burden of inquiry to determine whether or not the property is occupied or used in such a way to substantiate a homestead claim, even if the claimant has declared another

premise as a homestead.

However, according to a constitutional amendment to Article 16, Section 50, passed by Texas voters in 1995, "A purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant." The key to this amendment is what constitutes "without actual knowledge."

If the homestead is sold, the proceeds retain their homestead character for six months. Should the funds be reinvested in another homestead during this period, the funds cannot be claimed by creditors. Of course, the funds must be traceable from the sale of the first homestead to the purchase of the second. If one homestead is exchanged for another (a like-kind exchange), creditors cannot reach the new homestead.

Reinvesting Proceeds

Should the homestead be subjected to an involuntary sale, such as condemnation, Texas case law gives the former owner a reasonable opportunity to reinvest in other exempt property. No exact time limit is specified. According to the Internal Revenue Code, the former owner must reinvest the proceeds within two years or be subject to income taxes on any gain.

Finally, the proceeds from an insurance policy covering the homestead are exempt from levy for six months from the date when the owner had a right to demand payment from the insurer.

Homestead rights can, in some circumstances, protect occupants from being ousted by the lawful owner of the property. For example, suppose the home is the husband's separate property. The husband dies and leaves the premises to a third party in his will. Can the family continue to occupy the premises even though the property belongs to a third party?

According to the Texas Property Code, the survivor has the right to occupy the homestead for the remainder of his or her life, regardless of who receives the property upon the death of the first spouse. Likewise, when both spouses die leaving minor children, the guardian of the minor children may continue to occupy the homestead under the order of the property court even though title is vested in a third party. When the court no longer permits the guardian to use and occupy the premises, homestead protection ceases for the minor or unmarried child.

A valid sale of the homestead requires the signature of both spouses regardless of whether it is community property or the separate property of one spouse. Homestead rights under the Probate Code terminate when the surviving spouse dies, sells the homestead or abandons it without surviving minor or unmarried children.

Filing Tax Exemptions

Although not directly a part of homestead rights, another benefit of owning a home in Texas is lower county and school property taxes. To lower taxes, the owner of a residence homestead must file for the homestead tax exemption with the Central Appraisal District. Only one filing is necessary. However, the applicant must notify the Central Appraisal District when the dwelling is no longer qualified as a homestead.

The Texas Property Tax Code defines a residence homestead as an occupied residential structure together with as much as 20 acres of land and improvements. The structure must be occupied as the principal residence by an owner qualified for the exemption.

The appropriate filing entitles the resident homestead owner to:

- A \$3,000 exemption from the assessed value of the residence homestead for county purposes authorized in Article VIII, Section 1-a, of the Texas Constitution
- A \$15,000 exemption from the appraised value of the adult's residence homestead by a school district for school tax purposes

- Where authorized by Section 11.13(n) of the Texas Property Tax Code, an additional exemption of no less than \$5,000 when the exemption has been adopted by the governing body of the taxing unit.

If the resident homestead owner is disabled or 65 or older, the resident is entitled to an additional \$10,000 exemption from the appraised value of the residence homestead by a school district for school-tax purposes. For more information on the exemptions, see "The Texas Property Tax System, publication 1192.

Homestead Restrictions

Homestead rights are a unique part of Texas real property law. Both homeowners and real estate practitioners need to understand these laws because of the restrictions placed on real property.

Although the homestead laws carry these restrictions, they protect a valuable possession—the home.

For more information about other areas concerning the homestead, see "Protecting Nonexempt Assets" publication 953. The article discusses the legality of converting nonexempt assets that can be seized by creditors into exempt assets such as the homestead. Also, see "Homesteads and the Elderly" publication 857. This article reviews the provisions of the Texas Tax Code that ease the burden of property taxes on the elderly.

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