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TO: Clients and Friends

FROM: David F. Dulock

SUBJECT: Home Improvement Lending on Texas Homesteads – Final Agency Interpretations of Section 50(a)(5), Article XVI, Texas Constitution

The Finance Commission of Texas and the Texas Credit Union Commission ("Commissions") have jointly issued their final interpretations of Section 50(a)(5), Article XVI, of the Texas Constitution relating to the creation of a valid home improvement lien on a Texas homestead. These interpretations were published in the July 1, 2005 issue of the Texas Register (Vol. 30, No. 26) and will become effective July 7, 2005. They are codified in the Texas Administrative Code in 7 TAC §§152.1, 152.3, 152.5 152.7, and 152.15.

This memorandum is comprised of four sections. The first section is the text of Section 50(a)(5), Article XVI, of the Texas Constitution. The second section is a redaction of the preamble to the interpretations published in the Texas Register and consists of the Commissions' reasoning for and summary of the interpretations. The third section is the text of the interpretations as published in the Texas Register. The fourth section contains our comments on the interpretations.

I. Section 50(a)(5):

(a) The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:

(5) work and material used in constructing new improvements thereon, if contracted for in writing, or work and material used to repair or renovate existing improvements thereon if:

(A) the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead;

(B) the contract for the work and material is not executed by the owner or the owner's spouse before the fifth day after the owner makes written application for any extension of credit for the work and material, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing;

(C) the contract for the work and material expressly provides that the owner may rescind the contract without penalty or charge within three days after the execution of the contract by all parties, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing; and (D) the contract for the work and material is executed by the owner and the owner's spouse only at the office of a third-party lender making an extension of credit for the work and material, an attorney at law, or a title company.

II. Commissions' Preamble to Interpretations:

Section 50(a)(5) provides exceptions from the protections from forced sale of the homestead of a family or of a single adult person for payment of the following two debts when they meet certain requirements:

- (1) work and materials used in constructing new improvements on the homestead; and
- (2) work and materials used to repair or renovate existing improvements on the homestead.

Section 50(a)(5) does not define any of its terms. When a term is not defined in Section 50(a)(5), the interpretations give it its ordinary meaning.

The language of Section 50(a)(5) raises a question as to whether Section 50(a)(5)(A) - (D) apply to "work and materials used to repair and renovate existing improvements" alone or also to "work and materials used in constructing new improvements." The Texas Supreme Court held "that a plain-language reading of Texas Constitution Article XVI, Section 50(a)(5) dictates that the protections in Section 50(a)(5)(A) - (D) apply only to 'work and material used to repair or renovate existing improvements' on homestead property, and not to 'work and material used in constructing new improvements'." *Spradlin v. Jim Walter Homes, Inc.*, 34 S.W.3d 578, 580 (Tex. 2000).

To determine whether to apply Section 50(a)(5)(A) - (D) to a debt under Section 50(a)(5), a determination must be made as to whether the work and materials used are for "constructing new improvements" on the homestead or "repairing or renovating existing improvements" on the homestead. To make this determination, the Commissions concluded that "new improvements" and "existing improvements" must be defined. The plain language of Section 50(a)(5) dictates that "new improvements" are additions to real property that do not exist on the real property prior to entering into a contract for home improvements and construction of the additions will not involve work or materials being physically attached to an existing improvement. The plain language of Section 50(a)(5) further dictates that "existing improvements" are additions to real property that are physically attached to the real property prior to entering into a contract for home improvements. For example, a pool cabana could be constructed separate from all other pre-existing improvements; this would be construed to be new improvements as the construction would not be physically attached to any pre-existing improvements. A pool cabana could also share a wall with an existing garage; this would be construed to be existing improvements as the cabana would be physically connected or attached to the pre-existing garage. The phrases "new improvements" and "existing improvements" are defined at §152.1(2) and (3) respectively.

Work and materials used to construct improvements on a homestead that already has "existing improvements" on it are considered "work and materials used in constructing new improvements" so long as work is not performed on and materials are not physically attached to the existing

improvements. Work that is performed on or materials that are in any way physically attached to existing improvements are considered "work and materials used to repair or renovate existing improvements" on the homestead, and Section 50(a)(5)(A) - (D) must be complied with to establish a lien on the homestead.

The definition of "contract" in §152.1(1) is provided solely to provide a shorthand version of the phrase "contract for work and material;" the definition allows the interpretations to use the term "contract" instead of the phrase "contract for work and material." The definition requires that the contract comply with the Texas Constitution and Texas Property Code.

The definition of "existing improvement" in §152.1(2) and the definition of "new improvement" in §152.1(3) are discussed above. "New improvements" and "existing improvements" must be physically attached to the homestead.

The definition of "material" in §152.1(4) clarifies that materials become a part of improvements once physically attached to the improvement, whether in the construction of new improvements or the repair or renovation of existing improvements.

For consistency, the definition of "owner" in §152.1(5) is the same as the definition in §153.1(13). *{Home equity interpretations}*

Section 152.1(6) defines "physically attach" in order to avoid confusion by clarifying what this term means in the interpretations.

Section 152.1(7) defines "repair or renovate" and clarifies that only existing improvements can be repaired or renovated. Section 152.1(7) describes the kind of "work and material" that are considered repairs and renovations and provides examples.

Section 152.1(7)(A) provides that replacing material with the same or similar material on existing improvements is a repair or renovation. "Repair or renovation," as defined in §152.1(7)(B), includes attaching material to existing improvements where the same or similar material were not attached to the existing improvements when the repair or renovation began. Section 152.1(7)(C) makes it clear that the work performed does not have to physically attach material to the homestead to be considered a repair or renovation. Section 152.1(7)(C) additionally includes in the definition of "repair or renovate" work and material used where materials are actually removed from the homestead, but not thereafter replaced by material of any kind.

The definition of "title company" in §152.1(8) is consistent with the definition given by the court in *Rooms with a View, Inc. v. Private National Mortgage Association, Inc.*, 7 S.W.3d 840 (Tex.App. - Austin 1999), which includes an agent of a title insurance company. This definition, along with the *Rooms with a View* decision should remove the uncertainty that precipitated the *Rooms with a View* case.

Section 152.3 explains that the only requirement in Section 50(a)(5) for establishing a lien on a homestead for a debt incurred for "work and material used in constructing of new improvements" *{sic}* is that the "work and material used in constructing new improvements" be "contracted for in writing." In Texas, there may be both a constitutional and a statutory lien. The requirements to establish a statutory lien are in Property Code §§53.001 *et seq.*; however, this interpretation does not address the Property Code requirements. As stated above, this interpretation is supported by the Texas Supreme Court decision in *Spradlin*, 34 S.W.3d at 580.

Section 152.3(b) provides that a homestead is not protected from forced sale by Section 50 once a lien is established for debt incurred for work and material used in constructing new improvements.

Section 152.5(a) explains that Section 50(a)(5)(A) - (D) apply only to work and material used to repair or renovate existing improvements. This interpretation is also supported by the Texas Supreme Court in *Spradlin*.

Section 152.5(b) provides that to establish a lien for a debt incurred for work and material used to repair and renovate existing improvements, there must be compliance with Section 50(a)(5)(A) - (D).

The Commissions recognize that parties may reach an agreement to construct new improvements and repair or renovate existing improvements in the same contract. The Commissions, in §152.5(c), provide that a single contract pertaining to both must comply with Section 50(a)(5)(A) - (D) to establish a constitutional lien on the homestead.

Section 152.7 interprets the consent requirement in Section 50(a)(5)(A) as meaning the joinder requirement in Section 5.001 of the Texas Family Code. In the case of a family homestead, Section 50(a)(5)(A) requires the "consent of both spouses" to the contract for work and material, "given in the same manner as is required in making a sale and conveyance of the homestead." Section 5.001 [Texas Family Code] provides that: "Whether the homestead is the separate property of either spouse or community property, neither spouse may sell, convey, or encumber the homestead without the joinder of the other spouse except as provided in this chapter or by other rules of law." The Commissions believe that the joinder in Section 5.001 is what the drafters were most likely referring to when they required "consent of both spouses. . . ."

In keeping with *Spradlin*, §152.15(a) limits the requirements of Section 50(a)(5)(D) to repairs or renovations of existing improvements.

Section 152.15(b) makes it clear that the requirements of Section 50(a)(5)(D) are not fulfilled by executing contracts at a mobile office of the lender, an attorney at law, or a title company, unless the mobile office is located at the permanent address of the lender, an attorney at law, or a title company.

III. Interpretations:

152.1. Definitions.

Any reference to Section 50 in this interpretation refers to Article XVI, Texas Constitution, Section 50. Words and terms have these meanings when used in this chapter, unless the context indicates otherwise:

(1) Contract--A contract for work and material that complies with the Texas Constitution and the Texas Property Code, used to:

(A) construct new improvements;

(B) repair or renovate existing improvements; or

(C) both subparagraphs (A) and (B) of this paragraph.

(2) Existing improvements--A pre-existing addition to a homestead that is physically attached to the homestead.

(3) New improvements--An addition physically attached to a homestead:

(A) that does not exist on the homestead prior to the commencement of the use of work and material to physically attach the new improvements to the homestead under Section 50(a)(5); and

(B) the construction of which will not involve:

(i) work on existing improvements

(ii) the use of material on existing improvements; or

(iii) physically attaching material to existing improvements.

(4) Material--Material used in constructing new improvements or repairing or renovating existing improvements. Material alone is not improvements. Material used to construct new improvements becomes a part of the new improvements once physically attached to the new improvements. Likewise, material used to repair or renovate existing improvements becomes a part of the existing improvements once physically attached to the existing improvements.

(5) Owner--A person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead.

(6) Physically attach--To permanently attach, affix, add to, or fasten onto.

(7) Repair or Renovate--Work and material used to:

(A) replace material physically attached to existing improvements whether or not the new material is similar to or the same as the material being replaced (examples include replacing flooring, roofing, built-in appliances, siding, windows, or other material that is attached to existing improvements);

(B) physically attach material to existing improvements where there is no previously attached material being replaced that is the same as or similar to the material being attached (examples include attaching to existing improvements a new room, a built-in cabinet, or a second story); and

(C) mend, remedy or upgrade all or a portion of existing improvements without adding or replacing material to the existing improvements (examples include restoring wood flooring or woodwork of an existing improvement where the work does not include physically attaching material to the existing improvements, and removing flooring to expose flooring underneath).

(8) Title company--A title insurance company or an agent of a title insurance company.

§152.3. Requirements for Construction of New Improvements: Section 50(a)(5).

(a) Except as provided in §152.5(c) of this chapter, Section 50(a)(5)(A) - (D) does not apply to the construction of new improvements on a homestead.

(b) A valid lien, under Section 50(a)(5), may be created on a homestead if the debt for the work and material used for new improvements is contracted for in writing. Once the lien is created, the homestead is not protected by Section 50 from forced sale for the payment of the debt.

§152.5.Requirements for Work and Material Used to Repair or Renovate: Section 50(a)(5)(A) - (D).

(a) Section 50(a)(5)(A) - (D) applies only to contracts and applications for work and material used to repair or renovate existing improvements.

(b) If debt is incurred for work and material used to repair or renovate existing improvements and the requirements of Section 50(a)(5)(A) - (D) have been met, a lien is established on the homestead of a family, or of a single adult person, and it is not protected by Section 50 from forced sale for the payment of the debt.

(c) If the application and contract are for both work and material used to repair or renovate existing improvements and for work and material used in constructing new improvements, the entire transaction is considered a contract to repair and renovate existing improvements and compliance with the constitutional requirements of Section 50(a)(5)(A) - (D) is required to establish a lien on the homestead.

§152.7.Consent of Spouses in the Case of Family Homestead: Section 50(a)(5)(A).

(a) In the case of a family homestead, both spouses must consent in writing to the contract for repair or renovation of existing improvements, regardless of whether the spouse has a community property interest or other ownership interest in the homestead.

(b) In addition to the consent of both spouses of a family homestead, the lender or contractor, at its option, may also require all other owners and their spouses to consent to the contract.

§152.15.Place for Execution of Contract for Work and Material: Section 50(a)(5)(D).

(a) The persons granting or acknowledging the encumbrance *{sic}* of their homestead interest must execute the contract for work and material used to repair or renovate existing improvements at the permanent physical address of:

(1) the office or branch office of a third-party lender making an extension of credit for the work and material;

(2) an attorney at law; or

(3) a title company.

(b) Execution of the contract may not occur at a mobile office located at:

(1) the homestead; or

(2) any other place not permitted by subsection (a) of this section.

IV. Our Comments:

§152.1.Definitions.

Contract (§152.1(1)): There is no authority for creating a lien on Texas homestead without also complying with the enabling statutory requirements of Section 53.254 of the Texas Property Code. Even *Spradlin* recognized this when the court held that although the contractor's lien was "valid under Section 50", the court did not "consider whether [the contractor's] lien fulfills the requirements of Texas Property Code section 53.254." (*Spradlin* at 582) Thus, *Spradlin* is in

accord with a long line of Texas decisions that both constitutional and statutory requirements must be complied with before a valid lien is created against Texas homestead. The Commissions also recognized this in their preamble to the interpretations when they stated that: “Because Section 50 primarily addresses only the elements necessary to create a valid lien on a homestead, other statutes and constitutional provisions must also be consulted to fully evaluate the legality under Texas law of credit transactions involving the homestead.” And, again, these constitutional and statutory requirements were recognized in the definition of “Contract” as “[a] contract for work and material that complies with the Texas Constitution and the Texas Property Code”

New improvements (§152.1(3)): The preamble to the interpretations gives an example of a newly constructed pool cabana being attached to an existing garage, thereby making the cabana “Existing improvements” (see §152.1(2) when no cabana existed prior to construction. This concept is carried forward in §152.1(3)(B)(iii) of the definition, which excludes “physical attaching material to existing improvements” from the definition of “New improvements.” While we understand the reason for this exclusion as it relates to new additions to the homestead that are integrated into and physically become an indistinguishable part of “Existing improvements,” we are concerned that this interpretation makes the addition of a distinct new improvement to the homestead “Existing improvements” simply because this new addition to the homestead is tangentially connected to “Existing improvements.” For example, the addition of a swimming pool or spa that is connected to existing homestead electrical and plumbing systems; or the addition of a fence or deck that is superficially attached to exterior surfaces of “Existing improvements.”

Owner (§152.1(5)): We are concerned that when property is jointly owed and one or more of the owner(s) occupies the property as homestead and the remaining owner(s) do not, this definition would require compliance with §50(a)(5)(B)-(D) for the non-homestead owners, thereby expanding Texas homestead law, as expressed in the Texas constitution, statutes and judicial decisions, beyond protecting only homestead interests in property. It also conflicts with interpretation §152.7(b), which makes joinder by non-homestead owners optional.

§152.3.Requirements for Construction of New Improvements: Section 50(a)(5).

We are concerned that the wording of §152.3(b) that “[a] valid lien, under Section 50(a)(5), may be created on a homestead if the debt for the work and material used for new improvements is contracted for in writing” is misleading. As we stated in our comments on the definition of “Contract”, there is no authority for creating a lien on Texas homestead without also complying with the enabling statutory requirements of Section 53.254 of the Texas Property Code. More importantly, §152.3(b) appears to conflict with the definition of “Contract” in §152.1(1), which states that a contract creating a lien against Texas homestead must also comply with the Texas Property Code.

§152.5.Requirements for Work and Materials Used to Repair or Renovate: Section 50(a)(5)(A) - (D).

In this interpretation, §152.5(b) states that: “If debt is incurred for work and material used to repair or renovate existing improvements and the requirements of Section 50(a)(5)(A) - (D) have been met, a lien is established on the homestead of a family, or of a single adult person, and it is not protected by Section 50 from forced sale for the payment of the debt.” How will this interpretation co-exist with the statutory requirements of Section 53.254 of the Texas Property Code, which mandates additional requirements to fix an improvement lien against Texas homestead, i.e. – that: “(b) [t]he contract must be executed before the material is furnished or the labor is performed” and “(e) [t]he contract must be filed with the county clerk of the county in

which the homestead is located.” Section 53.254 contains the enabling statutory requirements for perfecting a lien for improvement against Texas homestead under Section 50(a)(5). Although the interpretations’ preamble states that “Section 50 primarily addresses only the elements necessary to create a valid lien on a homestead, other statutes and constitutional provisions must also be consulted to fully evaluate the legality under Texas law of credit transactions involving the homestead,” §152.5(b) appears to interpret Section 50 to permit a lien against Texas homestead without requiring compliance with Section 53.254(b) and (e) of the Texas Property Code. Compliance with the requirements of Section 53.254 for a valid lien is even acknowledged by the Supreme Court in *Spradlin* when it stated that: “We do not consider whether JWH’s lien fulfills the requirements of Texas Property Code section 53.254.” (*Spradlin* at 582, fn 2). As previously noted, the *Spradlin* case does not stand for the proposition that a lien may be established on a homestead independent of statutory requirements (*Spradlin* at 582, fn.2). The court’s statement in *Spradlin* that “the resulting lien is valid under Section 50” (*Spradlin* at 582) is not the same as stating that a valid lien is created under other Texas law that applies.

We believe that the interpretation in §152.5(c) is contrary to the decision in *Spradlin*, which holds “that a plain-language reading of Texas Constitution Article XVI, Section 50(a)(5) dictates that the protections in its subparts (A) through (D) apply only to ‘work and material used to repair or renovate existing improvements’ on homestead property, and not to ‘work and material used in constructing new improvements.’” (*Spradlin* at 582). *Spradlin* makes no exception for a contract for new improvements that also includes repair or renovation of existing improvements. The facts which dictate how contracts are drafted are too numerous to be fairly covered by §152.5(c). Certain facts may dictate that a contract be drafted in such a manner that the construction of “New improvements” and the repair or renovation of “Existing improvements” are distinct portions and not dependent upon one another. Others facts may dictate that a contract be drafted in such a way that the construction of “New improvements” and the repair or renovation of “Existing improvements” be closely connected for proper completion of the contract. We recognize this is a difficult issue but are of the opinion that the Texas appellate courts are the best venue to decide this issue as particular facts dictate.

§152.15.Place for Execution of Contract for Work and Materials: Section 50(a)(5)(D).

The interpretation in §152.15(a)(1) does not clarify the term “third-party lender making the extension of credit for the work and material.” In the Commissions’ home equity interpretations the term “lender” is defined as “anyone authorized under section 50(a)(6)(P) that advances funds directly to the owner or is identified as the payee on the note.” No such definition is contained in the home improvement interpretations and we are left wondering in a table-funded home improvement transaction who is the “lender” for the purpose of “place for execution.”

This Memorandum is provided for the general information of the clients and friends of our firm only and is not intended as specific legal advice. You should not place reliance on this general information alone but should consult counsel regarding the application of the laws and official agency interpretations discussed in this Memorandum to your specific case or circumstances.