

In the United States Bankruptcy Court

for the Northern District of Iowa

MICHAEL LOUIS OLTHOFF
Debtor(s).

Bankruptcy No. X89-00652F
Chapter 7

MEMORANDUM AND ORDER RE: OBJECTION TO HOMESTEAD EXEMPTION

The National Bank of Rockwell City (BANK) objects to debtor's claim of exemption in his homestead. A hearing was held in Fort Dodge, Iowa on June 15, 1989. The court now issues the following ruling which shall constitute findings of fact and conclusions of law pursuant to the requirements of Bankr. R. 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACT

The debtor, Michael Louis Olthoff, initially filed a joint voluntary chapter 7 petition with his former wife, Karen Olthoff, on November 7, 1988. On March 22, 1989, the court ordered that the joint petitions in the bankruptcy case be severed. The debtors were ordered to file separate, amended petitions. Debtor Michael Olthoff filed an amended petition on May 2, 1989 and was assigned a new case number, X89-00652F. The amendment was retroactive to the date of the filing of the original joint petition on November 7, 1988.

As part of the initial filings, debtors Michael and Karen Olthoff claimed as exempt a homestead located at 1021 North Seneca Street, Storm Lake, Iowa. The homestead was alleged to have a value of \$14,500.00. The case trustee, James Cossitt, filed an objection to the homestead exemption on December 14, 1988. Bank

filed an objection to the homestead exemption on January 3, 1989.

In compliance with the order severing cases, debtor Michael

Olthoff filed a new set of schedules on May 2, 1989. On schedule B-4, the debtor claimed as exempt the home at 1021 Seneca Street. In its order severing the jointly filed cases, the court ordered it necessary for the trustee and Bank to renew any objections to claims of exemption. Subsequently, on May 4, 1989, Bank filed an objection to debtor's claimed homestead exemption. The trustee, James Cossitt, did not file a new objection.

Since February, 1988, the debtor has resided at the property claimed as exempt. His former wife, Karen Olthoff, does not claim an exemption in the homestead property.

Bank made a loan to the debtor in February, 1985 for the purpose of purchasing a home in Twin Lakes, Iowa. A mortgage on the home was taken as security. The balance on the first mortgage note is

approximately \$40,000.00. A non-judicial foreclosure of the first mortgage is presently pending. James Patton, Bank president, testified that the value of the mortgaged property is \$31,500.00. The debtor testified that in his opinion the value of the house in Twin Lakes is \$45,000.00.

In September, 1985, Bank issued a note to the debtor in the amount of \$600.00. A 1976 Ranchero was given as collateral for this note.

In early 1986, Bank began making additional loans to the debtor. The purposes for the loans were for payment of living and medical expenses. Evidencing the advances, debtor executed

promissory notes to Bank on the following dates and in the following amounts:

Date Amount of Note

1/3/86 \$ 1,000.00

1/21/86 1,000.00

2/10/86 1,000.00

2/24/86 600.00

3/28/86 4,685.75

4/28/86 1,000.00

5/19/86 600.00

6/16/86 200.00

7/2/86 500.00

7/15/86 200.00

8/15/86 250.00

9/8/86 700.00

10/2/86 500.00

11/12/86 300.00

The \$600.00 note dated May 19, 1986 was signed by both Michael Olthoff and Karen Olthoff. The other notes were signed by Michael Olthoff only. Bank had a guarantee from Karen for all of the notes. Eventually all of the notes were consolidated into one note. The amount of the note was approximately \$14,675.00.

In November, 1986, to provide security for this debt, the debtor and Karen Olthoff gave Bank a second mortgage on the real estate located in Twin Lakes. The debtor made no payments on the consolidated note secured by the second mortgage.

Bank obtained a judgment against Olthoffs on the second mortgage note in Iowa District Court in Calhoun County but did not foreclose its mortgage. A transcript of this judgment was filed February 4, 1988 in Buena Vista County, Iowa against Olthoffs in favor of Bank in the sum of \$16,776.14 plus interest after December 28, 1987 at the rate of \$5.23 per day plus costs totaling \$89.70. The judgment at the time of bankruptcy would have been \$18,487.14.

The debtor purchased the Storm Lake property in the early part of 1988. The sales agreement, which was executed on January 28, 1988, indicates that the purchase price for the home was \$15,000.00. A court officer's deed was issued to the debtor on February 13, 1988.

All of the funds used to purchase the new homestead came from debtor's \$32,000.00 lump sum worker's compensation settlement.

Approximately \$7,000.00 of the worker's compensation proceeds were used to make improvements to the kitchen of the new home. Approximately \$4,000.00 of the worker's compensation proceeds were used to purchase furniture. The remaining \$6,000.00 of the settlement were used for living expenses.

The debtor testified that he moved out of his original homestead in Twin Lakes in May, 1986. It was at that time, he became separated from his wife.

On schedule A-3 to the debtor's amended petition, the debtor listed the following unsecured creditors:

Name of Creditor When Claim Incurred Amount of Claim

Calhoun Co. Treasurer 1986-1988 \$ 322.70

City of Rockwell City 1985 80.80

IRS 1986 521.35

First Fed. Sav. & Loan 1985 2,000.00

William Habhab 1988 1,190.00

ITT 1983 2,000.00

Keith Insurance 1985 2,402.93

Montgomery Ward Unknown 296.56

McCrary Rost Clinic, P.C. 7-31-88 515.00

Power Coop Employee

Credit Center 1986 3,269.21

Sears, Roebuck 1984 1,371.15

United Guaranty Residential

Ins. Co. of No. Car. 1986 3,269.21

Union State Bank Unknown 1,164.75

The debtor testified at the hearing that the debt to Montgomery Ward was incurred sometime in 1985. Debtor also testified that the debt to the Union State Bank was incurred in 1987. Additionally, the debtor testified that the debt listed as owed to McCrary Rost Clinic, P.C. was not his debt. He stated that the debt belonged to his ex-wife and was incurred after the divorce.

DISCUSSION

The issue before the court is whether the debtor's homestead located in Storm Lake, Iowa is exempt or more precisely, whether it is liable for any of his debts and if so, to what extent. The debtor claims that the property is exempt as a homestead despite debts existing prior to his acquisition of the home because it was purchased with proceeds of an exempt worker's compensation settlement.

Bank argues that debts exist which were contracted for prior to the acquisition of the homestead and therefore the debtor is not entitled to the claim of the homestead exemption. Section 561.21 of the Iowa Code sets out the types of debts

for which a homestead may be sold. Section 561.21(1) provides:

The homestead may be sold to satisfy debts of each of the following classes:

(1) those contracted prior to its acquisition, but then only to satisfy deficiency remaining after exhausting the other property of the debtor, liable to execution.

Bank was a creditor prior to the debtor's acquisition of the homestead. Bank had loaned money to the debtor during the period of September, 1985 through November, 1986. These loans, which were later consolidated into one note, were made to the debtor for his living and medical expenses. All of these debts were incurred prior to the debtor's purchase and occupation of the homestead in January, 1988. The bank obtained a judgment against the debtor and Karen Olthoff in the sum of \$16,776.14 plus interest. A transcript of judgment was filed February 4, 1988 in Buena Vista County, Iowa. The judgment was entered in favor of the bank prior to the debtor's receiving of a deed to the homestead property. Debtor introduced no evidence that he occupied the property as a homestead prior to the date of the deed.

Schedule A-3 (creditors having unsecured claims without priority) indicates that debtor incurred a number of other debts prior to the purchase of the homestead in Storm Lake. The homestead may be sold to satisfy those debts that were contracted prior to the acquisition of the homestead. Iowa Code § 561.21(1). See also In re Ellingson, 82 B.R. 88, 89-90 (N.D. Iowa 1986); In re Schuldt, 91 B.R. 501 (Bankr. S.D. Iowa 1988); In re Nehring, 84 B.R. 571 (Bankr. S.D. Iowa 1988).

The debtor does not dispute that there were debts contracted prior to the acquisition of the homestead. However, the debtor argues that the homestead should be exempt because it was purchased with worker's compensation proceeds, which are exempt under another exemption provision. Section 627.13 of the Iowa Code provides: "Any compensation due or that may become due an employee or dependent under the provisions of chapter 85 shall be exempt from garnishment, attachment, and execution." Chapter 85 is the workers' compensation chapter of the Iowa Code.

All of the money used by the debtor to purchase the homestead property in Storm Lake and to repair its kitchen were derived from the worker's compensation claim.

The court recognizes that a liberal construction must be placed upon the Worker's Compensation Act in order to accomplish the object and purpose of the legislation. See Jacques v. Farmers Lumber & Supply Co., 242 Iowa 548, 47 N.W.2d 236, 238 (1951). The court also recognizes that the Iowa courts have liberally interpreted the homestead exemption. See American Savings Bank v. Willenbrock, 209 Iowa 250, 228 N.W. 295, 297 (1929).

It may be that the worker's compensation proceeds would have been exempt if at the time of the bankruptcy filing they were in the form of a bank deposit account or cash held by the debtor. Cf. MidAmerica Savings Bank v. Miehe, 438 N.W.2d 837, 839 (Iowa 1989) (personal earnings exempt from garnishment which can be traced to a checking account or savings account in a financial institution, continue to be exempt from creditors' levies); Staton v. Vernon, 209 Iowa 1123, 229 N.W.2d 763, 764 (1930) (earnings did not lose exempt character by reason of being deposited in bank account).

However, the worker's compensation proceeds lost their exempt status as worker's compensation benefits once they were spent by the debtor. The Iowa Supreme court has held: "The sale of exempt property causes the proceeds thereof to lose its exempt character." Iowa Methodist Hospital v. Long, 234 Iowa 843, 12 N.W.2d 171, 175 (1943). In that case, the court held that exempt wages which were invested in United States savings bonds lost their exempt character and the bonds were subject to seizure by judicial process. See also In re Bagnall's Guardianship, 238 Iowa 905, 29 N.W.2d 597, 602 (1947) (property purchased with proceeds of exempt disability compensation is subject to payment of beneficiary's debts).

Debtor cites to the court no authority to support his position. There is also no evidence to support the application of the provisions of Iowa Code § 561.20 in this case. If the home is to be set aside as exempt, it must be pursuant to Iowa Code § 561.16 and not by virtue of § 627.13.

The court finds and concludes that the debtor incurred a number of debts prior to the acquisition of the homestead for which the homestead may be liable. These debts include:

Creditor Amount

City of Rockwell City \$ 80.80

IRS 521.35

First Federal Savings & Loan 2,000.00

ITT 2,000.00

Keith Insurance 2,402.93

Montgomery Ward 296.56

Power Coop Employer Credit Center 3,269.21

Sears 1,371.15

United Guaranty Residential 3,269.21

Ins. Co. of No. Car.

Total \$15,211.21

In addition, the debtor became indebted to Bank prior to acquisition of the homestead. Bank has obtained a judgment for this debt which, on the date of bankruptcy, amounted to approximately \$18,507.56.

The homestead may be sold to satisfy these debts, if there is a deficiency remaining after exhausting other non-homestead property of the debtor which is liable to execution. Iowa Code §

526.21(1). See also In re Mosher, 79 B.R. 840, 842 (S.D. Iowa 1987) (creditor must exhaust other property liable to execution before homestead may be sold).

The court is not deciding at this time whether Bank has a judgment lien against the debtor's homestead which is superior to any interest arising out of the trustee's rights and powers under 11 U.S.C. § 544.

CONCLUSIONS OF LAW

Debtor's homestead may be sold to satisfy debts of \$33,718.77 after all other non-exempt pre-petition property of the debtor is liquidated.

ORDER

IT IS ORDERED that National Bank of Rockwell City's objection to homestead exemption is sustained. Debtor's homestead may be sold to satisfy debts of \$33,718.77 after all other non-exempt prepetition property of the debtor is liquidated.

SO ORDERED THIS 6th DAY OF JULY, 1989.

William L. Edmonds
Chief Bankruptcy Judge