

In the United States Bankruptcy Court

for the Northern District of Iowa

DEAN A. THOMPSON and ARLANA A.
THOMPSON
Debtors.

Bankruptcy No. 95-32455XF

Chapter 7

ORDER RE: OBJECTION TO CLAIM OF EXEMPTIONS

The matter before the court is Trustee Habbo G. Fokkena's objection to the debtors' claim of exemption in their homestead. The parties have filed a "Joint Stipulation on Exemption Objection" setting out the relevant undisputed facts and the legal issues. Document 21. They agree that the court may rule on the exemption issue on the basis of the stipulated facts. The court now issues its ruling. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(B).

FACTS

Dean and Arlana Thompson, husband and wife, filed a Chapter 7 bankruptcy petition on December 18, 1995. The Thompsons claimed their homestead exempt under Chapter 561 of the Iowa Code. The trustee objected on the ground that the Thompsons had contracted debt prior to acquisition of the homestead and thus the homestead was not exempt under Iowa Code 561.21(1).

The Thompsons purchased their homestead from Hawkeye Bank and Trust in Humboldt, Iowa. The real estate contract, dated March 18, 1988, was recorded in Humboldt County on March 21, 1988. Joint Stipulation, Exhibit A.

The Thompsons obtained the down payment from Arlana Thompson's parents, Robert and Marlys Townsend. The Thompsons borrowed a total of \$10,000, and used \$8,700 for the down payment and the remaining \$1,300 for other expenses related to the homestead.

The Thompsons took possession of the homestead on or after March 18, 1988. The exact date is unknown; however, it was after receipt of the \$10,000 and the signing of the real estate contract. They have continuously occupied the property as their homestead from the date of purchase to the present date.

The Thompsons did not transfer any funds from prior homesteads into this homestead. Prior to occupancy of this homestead, the Thompsons had lived with relatives or in rental property for a period of less than one year in Iowa. Prior to that, they had lived in Colorado in a home they had purchased. The Colorado home was relinquished by the Thompsons to the mortgage holder in lieu of foreclosure. The Thompsons received no funds from the home.

The Thompsons gave the Townsends a promissory note for \$10,000. Joint Stipulation, Exhibit B. The note appears to be dated March 18, 1988, payable over 18 months and due September 18, 1989. The

parties' stipulation as to the date of the note is unclear. Joint Stipulation 12. However, the date of the note is not material because the parties agree that the Thompsons incurred the debt prior to acquisition of the homestead.

The Thompsons made sporadic payments on the note. At least \$5,000 remains unpaid. This amount is the only debt that predates purchase of the real estate.

The fair market value of the Thompsons' homestead is approximately \$30,000. The Thompsons also own a residential rental property in Humboldt, Iowa valued at \$70,000. Both the homestead and rental property are security for a note with a balance due of approximately \$65,000.

DISCUSSION

The issue before the court is to what extent a homestead is exempt when debtors have pre-acquisition debt. The Thompsons have conceded that their homestead is not exempt to the extent of the \$5,000 pre-acquisition debt. They propose to pay the sum of \$5,000 to the Trustee and to keep the remaining equity. The Trustee argues the entire homestead equity is available to the bankruptcy estate once there is any pre-existing debt. The Trustee contends the Thompsons can avoid the sale of their homestead only by payment of the entire equity to the estate.

Another issue raised by the parties is whether any equity available to the estate would be distributed entirely to the pre-acquisition debt creditor or whether the usual bankruptcy distribution rules would apply. Decision now on this issue would be premature. The creditors who would be affected have not yet had notice or the opportunity to be heard. This issue may be addressed after the Trustee files his final report and gives notice of the proposed distribution to all creditors.

The Thompsons claim their homestead exempt under Iowa Code

561.16. Section 561.16 provides in part:

The homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary.

Iowa Code 561.16 (1995). The exception for pre-acquisition debt is found in 561.21(1) which states:

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 a deficiency remaining after exhausting the other property of the debtor, liable to execution.

Iowa Code 561.21(1) (1995).

Homestead statutes are to be liberally construed in favor of the owner of the home. Keane v. United Guar. Indem. Co. (In re Keane), 7 B.R. 844, 851 (Bankr. N.D. Iowa 1980); Hunt, Hill & Betts v. Moore, 219 Iowa 451, 258 N.W. 114, 115 (1934). "The exemption law should be so construed as to effectuate the very object which the legislature had in view when the statute was enacted." Olsen v. Lohman, 234 Iowa 580, 13 N.W.2d 332, 335 (Iowa 1944) (quoting Smith v. Quiggans, 65 Iowa 637, 22 N.W. 907, 908 (1885)).

The text of 561.21(1) states that the homestead may be sold to "satisfy debts" of particular classes. The exemption exception for pre-acquisition debt is further limited if the debtor owns other nonexempt property. The creditor must first execute on the other property, and then may satisfy any deficiency from the homestead. Under a plain reading of the statute, then, the existence of pre-acquisition debt does not necessarily entirely extinguish the homestead exemption. Even assuming a debtor has no other property, the creditor may reach the homestead only to satisfy the pre-acquisition debt. This interpretation of 561.21(1) promotes the policy to liberally construe the homestead law in favor of the exemption.

Case law supports this reading of 561.21(1). In Matter of Nehring, 84 B.R. 571 (Bankr. S.D. Iowa 1988), the debtors delivered a \$10,000 promissory note to Clapsaddle three years prior to the purchase of their homestead. Shortly after the purchase of their homestead, the debtors filed a Chapter 7 bankruptcy petition. The homestead was valued at \$8,000. The court held that the debtors could claim their homestead "exempt to the extent that it [was] not necessary to satisfy a deficiency with respect to Clapsaddle's claim" after all other nonexempt property had been sold. Id. at 576.

In Matter of Schuldt, 91 B.R. 501 (Bankr. S.D. Iowa 1988), the debtors' homestead was worth \$65,000 and was not encumbered by a mortgage. Their unsecured debts totaled more than \$140,000; most were incurred prior to acquisition of the homestead. The court held the homestead was not exempt "to the extent" of the deficiency on pre-acquisition debts after sale of other nonexempt property. Id. at 503. See also In re Marriage of McMorrow, 342 N.W.2d 73, 76 (Iowa 1983) (after-acquired homestead may be sold to satisfy delinquent child support installments, absent sufficient other nonexempt property).

In this case, the Thompsons have stipulated that the \$5,000 is a pre-acquisition debt, and have agreed to pay this amount to the trustee. The statute supports the Thompsons' position. The language in the homestead statutes does not support the trustee's argument that any pre-acquisition debt results in the loss of all equity, and the trustee's objection should therefore be sustained in part and overruled in part.

IT IS ORDERED that the trustee's objection to the debtors' claim of exemption in their homestead is sustained to the extent of \$5,000 and overruled as to the balance of the value of the homestead.

SO ORDERED THIS 29th DAY OF JULY 1996.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U.S. mail to: James McCarthy, Habbo Fokkena and U.S. Trustee.