

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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JOHN C. WAGNER AND  
DEBRA K. WAGNER

Bankruptcy No. 99-02428-C

*Debtor(s).*

Chapter 13

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JOHN C. WAGNER and  
DEBRA K. WAGNER

Adversary No. 00-9050-C

*Plaintiff(s)*

vs.

CHELSEA SAVINGS BANK

*Defendant(s)*

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### **ORDER RE: EXEMPT STATUS OF HOMESTEAD AND ENFORCEABILITY OF MORTGAGES**

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On June 15, 2000, the above captioned matter came on for hearing pursuant to assignment. Plaintiffs/Debtors John and Debra Wagner were represented by attorney Thomas Fiegen. Defendant Chelsea Savings Bank (the "Bank") was represented by attorney H.Raymond Terpstra II. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(B),(K).

#### **STATEMENT OF THE CASE**

Debtors seek a determination of the validity of the Bank's mortgages against their homestead. They assert the mortgages are unenforceable due to the absence of the homestead exemption waiver language required by Iowa Code sec. 561.22. The Bank asserts that Iowa Code sec. 561.22 does not apply to mortgages. Alternatively, the Bank asserts the mortgages are enforceable under Iowa Code sec. 561.21(2). It also argues that Debtors' outbuildings are not exempt pursuant to Iowa Code sec. 561.3.

#### **FINDINGS OF FACT**

Debtors live on an acreage outside the city limits of Chelsea, Iowa which is between four and five acres in size. The acreage contains a house and six outbuildings including a garage, a corn crib, sheds, and a barn. Mr. Wagner testified that the outbuildings are worth more than \$300 each. Debtors conduct farming operations on the acreage. Originally, they raised hogs and calves and grew row crops. Presently, Debtors have a cattle herd consisting of 22 cows and 18 calves, and they raise hay on the acreage. Debtors also lease 300 acres off-site for row crops.

Debtors' relationship with Chelsea Savings Bank began in 1987 when they bought their acreage. To purchase the acreage, Debtors obtained a \$60,000 mortgage from the Bank. Subsequently, Debtors refinanced with Farmers Savings Bank in Garwin, paying the Bank's mortgage in full. Facing foreclosure by the Garwin bank, Debtors returned to Chelsea Savings Bank to refinance.

The Bank granted Debtors an \$82,000 mortgage on August 28, 1996. This mortgage was subject to an FSA guarantee. The FSA agreement indicated that Debtors were currently farming and it required them to raise livestock on their acreage. Bank's Exhibit 3. Debtors used the mortgage funds to pay operating expenses and mortgage debts owed to the Garwin bank. This mortgage was secured by Debtors' acreage and a blanket lien on their farm products and equipment. Bank's Exhibit 5. The total amount due on the first mortgage, as of June 15, 2000, was \$87,183.15.

The Bank granted Debtors a \$38,000 second mortgage on January 27, 1997. Debtors used the money as a farm operating loan. Debtors' acreage and a blanket lien also secured the second mortgage. Bank's Exhibit 6. The total amount due on June 15, 2000 was \$23,539.95.

The 1996 and 1997 mortgages are on identical forms. Paragraph 23 of both mortgages addresses "Waivers". It states: "Borrower relinquishes all right of dower and waives all right of homestead and distributive share in and to the property. Borrower waives any right of exemption as to the Property." This paragraph is in the same size type as the remainder of the document and is not set out in bold.

### **CONCLUSIONS OF LAW**

The homestead right in Iowa is peculiarly favored. Gustafson v. Fogleman, 551 N.W.2d 312, 314 (Iowa 1996). "Iowa provides an extraordinarily expansive interpretation of the homestead exemption consistent with the societal purposes stated in the case law." In re Knode, No. 97-01814-C, slip op. at 3 (Bankr. N.D. Iowa Nov. 24, 1997). Courts liberally construe homestead exemptions in favor of debtors. See, e.g., In re Johnson, 880 F.2d 78, 83 (8th Cir. 1989); In re Linman, No. 98-03770-S, slip op. at 3 (Bankr. N.D. Iowa Aug. 20, 1999). However, the Court must take care not to depart from the express language of an exemption statute. In re Hahn, 5 B.R. 242, 244 (Bankr. S.D. Iowa 1980).

A homestead may be sold to satisfy debts in limited circumstances. Iowa Code sec. 561.21(2) allows the sale of a homestead to satisfy debts created by written contracts which expressly stipulate that the homestead is liable. This may occur only if some deficiency remains after exhausting debtor's other property pledged on the same contract. Iowa Code sec. 561.22 provides further protection of homestead rights for agricultural land, stating:

If a homestead exemption waiver is contained in a written contract affecting agricultural land as defined in section 9H.1, or dwellings, buildings, or other appurtenances located on the land, the contract must contain a statement in substantially the following form, in boldface type of a minimum size of ten points, and be signed and dated by the person waiving the exemption at the time of the execution of the contract: "I understand that homestead property is in many cases protected from the claims of creditors and exempt from judicial sale; and that by signing this contract, I voluntarily give up my right to this protection for this property with respect to claims based upon this contract."

For sec. 561.22 to be relevant, Debtors must use their homestead for agricultural purposes. Iowa Code sec. 9H.1(2) defines agricultural land as "land suitable for farming." Iowa Code sec. 9H.1(11) defines farming as "the cultivation of land for the production of agricultural crops . . . , grazing or production of livestock." This term has been discussed by the Iowa Court of Appeals in Qualley v. State Federal

Savings & Loan, 487 N.W.2d 353 (Iowa App. 1992). In Qualley, plaintiffs brought an action seeking to set aside a forfeiture of a real estate contract. Id. at 354. The court decided whether a portion of the land contained in the real estate contract was agricultural and subject to the farm mediation statute. Id. The court held that the land in question was agricultural land because it was used for raising alfalfa and taxed subject to the agricultural tax credit. Id. at 357.

Debtors use their acreage for raising livestock and growing hay. The definition of farming includes raising livestock and producing crops. Thus, Debtors are engaged in farming on their acreage which is land suitable for farming. The acreage is agricultural land and Iowa Code sec. 561.22 applies.

Sec. 561.22 was enacted in 1986 in response to the farm crisis in Iowa. 1986 Iowa Acts ch. 1214 § 8. The purpose of this legislation was to give extra protection to agricultural land. This heightened protection for agricultural land is evidenced by the 1987 amendment, about which the Iowa Senate stated:

This bill provides that only when agricultural land is affected by contract with a clause waiving a homestead exemption, must a statement explaining the consequences of the waiver be included in the contract and signed by the person waiving the exemption. A written contract affecting land that is not agricultural may be enforced as any other contract.

1987 Iowa Acts ch. 67 § 1. The legislature expressly intended to treat contracts affecting agricultural land differently from contracts affecting non-agricultural land. To waive the homestead exemption in a contract affecting agricultural land, the contract must contain the homestead exemption waiver language required by sec. 561.22.

The Bank contends that a mortgage does not fall under sec. 561.22 because a mortgage is not a contract. Mortgages are subject to the rules of contractual interpretation and construction. Freese Leasing, Inc. v. Union Trust & Savings Bank, 253 N.W.2d 921, 924 (Iowa 1977) (holding that the object of interpreting a mortgage is "to learn the meaning of the words used in the contract"). The U.S. Supreme Court refers to mortgages as "mortgage contracts." See, e.g., Nobleman v. American Savings Bank, 508 U.S. 228 (1993); Fidelity Fed. Savings & Loan Ass'n v. de la Cuesta 458 U.S. 141 (1982); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934). Moreover, three cases discussing sec. 561.22 assume that sec. 561.22 applies to mortgages. West Des Moines State Bank v. Mills, 482 N.W.2d 432, 433-34 (Iowa 1992); Peoples Bank & Trust Co. v. Lala, 392 N.W.2d 179, 190-91 (Iowa App. 1986); In re Morris, No. L88-00597C, slip op. at 5 (Bankr. N.D. Iowa Jan. 19, 1989). Finally, the security agreements incorporated into the mortgages are contracts. See, e.g., In re Phillips, 882 F.2d 302, 305 (8th Cir. 1989); In re Long, 774 F.2d 875, 882 (8th Cir. 1985).

A "contract" is defined as "an agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law." Black's Law Dictionary 318 (7th ed. 1999). The Bank's mortgages encompass the characteristics of a contract. The Bank and Debtors agreed to the mortgages and each side incurred obligations. The Bank loaned money to Debtors in exchange for security interests in Debtors' real and personal property. Further, case law refers to mortgages as contracts and applies sec. 561.22 to mortgages. The only conclusion which is tenable is that mortgages are contracts. The Bank's mortgages affect Debtors' agricultural land. Therefore, sec. 561.22 is applicable to this case as the mortgages are contracts affecting agricultural land.

Sec. 561.22 has been addressed in three cases in Iowa, once in the Bankruptcy Court and twice in the state courts. In Morris, No. L88-00597C, slip op. at 5, this Court discussed the lack of the statutorily

mandated homestead waiver language in promissory notes. A mortgage executed in 1983 contained a homestead exemption waiver, and the promissory notes referenced the 1983 mortgage. Id. at 5-6. The court held the mortgage was valid because sec. 561.22 did not apply to mortgages executed before 1986, the effective date of the statute. Id. at 8.

In West Des Moines State Bank v. Mills, 482 N.W.2d 432, 433-34 (Iowa 1992), the Iowa Supreme Court held sec. 561.22 applied only to agricultural land. It did not apply to defendants who took out a commercial loan encumbered by a mortgage on non-agricultural property. Mills, 482 N.W.2d at 434. The court was satisfied that the mortgage on non-agricultural land contained a sufficient homestead exemption waiver. Id. at 434. The court interpreted sec. 561.22 as intending to remind the person signing the waiver that the homestead exemption is important. Id. Mills does not provide guidance how sec. 561.22 applies in the present context.

In Peoples Bank & Trust Co. v. Lala, 392 N.W.2d 179, 190-91 (Iowa App. 1986), the court discussed the seriousness of the homestead waiver in agricultural property mortgages. It stated that "Peoples Bank had a duty to disclose the full legal effects of the mortgage on the Lala homestead and failed to present clear and convincing evidence to rebut the presumptive invalidity of the note and mortgage." Id. at 191. The court also discussed Iowa Code sec. 561.22. Id. at 190 n.2. In dicta, the court stated:

Section 561.22, which became effective May 30, 1986, further strengthens the longstanding special recognition which the legislature has given to the homestead. Section 561.22 was not in place at the time the trial court entered judgment against the Lalas. However, it codifies the concern we have that mortgages must make mortgagors fully aware of the legal effects of a note and mortgage on ordinarily exempt homesteads.

This interpretation of sec. 561.22 suggests that agricultural mortgages lacking the homestead exemption waiver language are presumptively invalid in Iowa.

A North Dakota case discussed the effect of a similar statute requiring a homestead waiver. Red River State Bank v. Reierson, 533 N.W.2d 683 (N.D. 1995). Debtors borrowed money to pay for farm operating expenses and granted the bank a mortgage on their homestead to secure the debt. Id. at 685. After failing to make payments on the mortgage, the bank began a foreclosure action. Id. at 685-86. Debtors asserted the bank did not comply with N.D.C.C. § 47-18-05.1(1), which states:

All mortgages on homesteads executed after June 30, 1987, which are not purchase money agreements must contain the following statement printed in a conspicuous manner and must be signed and dated by the person waiving the exemption at the time the contract is executed: "I understand that homestead property is in many cases protected from the claims of creditors and exempt from judicial sale and that, by signing this contract, I voluntarily give up my right to this protection for this property with respect to claims based upon this contract.

Id. at 686. The court held that by failing to strictly comply with the homestead waiver statute, the mortgage was unenforceable against debtors' homestead exemption. Id. at 688. Although the homestead waiver contained the exact language required by the North Dakota Statute, the waiver was not conspicuous. Id. at 687. Absent strict compliance with the homestead waiver statute, debtors did not knowingly waive their homestead exemption. Id.

The Iowa legislature passed sec. 561.22 to give extra protection to farmers and agricultural land. The legislature determined that contracts affecting agricultural land must contain the homestead

exemption waiver language set out in sec. 561.22. For sec. 561.22 to have any practical effect, lack of compliance must result in the mortgage being unenforceable against the exempt homestead. To suggest any other outcome ignores the intent of the legislature or assumes that the legislature passed a law with no intended consequences. To give full effect to the legislative intent, sec. 561.22 requires strict compliance to obtain a valid homestead waiver in contracts affecting agricultural land.

In summary, the mortgages and security agreements entered into by Debtor and the Bank are contracts affecting agricultural land subject to the requirements of Iowa Code sec. 561.22. Neither of the Bank's mortgages contain the homestead exemption waiver language required by sec. 561.22. Consequently, Debtors did not waive their homestead exemption. Debtors properly claimed the homestead exemption in their bankruptcy schedules. The Bank's mortgages are unenforceable against Debtors' exempt homestead.

### APPURTENANCES

The Bank argues that Debtors' outbuildings are not included in Debtors' exempt homestead. Iowa Code sec. 561.1 states a "homestead" embraces the house used as a home by the owner and may contain other appurtenances thereon, "habitually and in good faith used as part of the same homestead." Iowa Code sec. 561.3, titled "Dwelling and appurtenances", states:

[The homestead] must not embrace more than one dwelling house, or any other buildings except such as are properly appurtenant thereto, but a shop or other building situated thereon, actually used and occupied by the owner in the prosecution of the owner's ordinary business, and not exceeding three hundred dollars in value is appurtenant thereto.

The Iowa Supreme Court considered whether farm buildings were appurtenances included in a homestead exemption in In re Sueppel's Estate, 124 N.W.2d 154, 156 (Iowa 1963). The Court found that farm buildings including a barn, corn crib, machine shed, feed house and farrowing house were correctly included in the exemption as appurtenant to the use of the farm as a homestead. Id. at 157. It found that sec. 561.3 addressing exemption of an appurtenant building used in business was not applicable where the appurtenant buildings are used as part of a farm homestead. Id.

In Shaffer Bros. v. Chernyk, 107 N.W. 801, 802 (Iowa 1906), the court stated that improvements included in the homestead exemption as appurtenances are those necessary for the convenience of and suitability for homestead occupation. This is part of the historical right that an owner may maintain a homestead in a reasonable manner for its capacity and convenience as a home for the family. Ebersole v. Moot, 84 N.W. 696, 697 (Iowa 1900).

The court in In re Sears, 246 B.R. 881, 883 (Bankr. S.D. Iowa 2000), recently considered whether buildings the debtors used in their business were included as appurtenances to their homestead. The court distinguishes Sueppel's Estate on its facts. Id. at 888. In Sears, the debtors claimed one-half acre within city limits exempt, including buildings the debtors used in their repair and salvage business. Id. at 883. In Sueppel's Estate, a widow was setting off 40 acres of farmland including her dwelling and farm buildings as a homestead. 124 N.W.2d at 155. The Sears court perceived there may be a distinction between farming as a self-sufficient way of life and farming as a business in application of the homestead statute. 246 B.R. at 888.

The question the Court must answer here is whether Debtors' outbuildings are properly appurtenant to their homestead as opposed to used and occupied by them in the prosecution of their ordinary

business. Under secs. 561.1 and 561.3, if the outbuildings are reasonably necessary and suitable for Debtors' use of the acreage as a farm homestead, they are included in the homestead exemption. If they are, instead, used in Debtors' business, one of them is exempt to the extent of three hundred dollars in value.

The outbuildings are located on Debtors' four to five-acre tract. Debtors conduct farming operations on this acreage. They use the barn to operate their cattle operation, the corn crib to store grain, the sheds to store machinery and farm equipment, and the garage to store their cars. The garage is exempt as an appurtenance used habitually and in good faith as part of the exempt homestead dwelling. Debtors use the barn, corn crib and sheds to conduct farming operations. Under Sueppel's Estate, these buildings used for farming in connection with the homestead are exempt under sec. 561.1. The \$300 limitation of sec. 561.3 is not applicable in this case because the buildings are necessary for the convenience and suitability of Debtors' homestead occupation on their acreage where they live and conduct farming.

### CONCLUSION

Debtors' acreage is agricultural land and subject to sec. 561.22. The mortgages are contracts affecting agricultural land that require the statutory homestead exemption waiver. Neither of the mortgages contain the homestead exemption waiver required by sec. 561.22. Debtors did not waive their homestead exemption. Debtors' acreage, including the house and outbuildings, is exempt as their farm homestead.

WHEREFORE, for all the reasons set out herein, the Bank's mortgages are unenforceable against Debtors' exempt homestead.

SO ORDERED this 27th day of July, 2000.

Paul J. Kilburg  
Chief Bankruptcy Judge