



**BUSINESS LAW SECTION**

**INSOLVENCY LAW COMMITTEE**  
CALIFORNIA LAWYERS ASSOCIATION  
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**LEGISLATIVE PROPOSAL (BLS – 2018-001)**  
**REVISIONS TO CALIFORNIA CIVIL CODE SECTION 704.720**

**TO:** Office of Governmental Affairs  
**FROM:** Jeff Curl  
Business Law Section (the “Section”), Insolvency Law Committee (the “Committee”)  
**DATE:** June \_\_, 2018  
**RE:** Proposal by Insolvency Law Committee to Amend California Civil Code section 704.720(b) (six-month reinvestment requirement of the homestead exemption).

**SECTION ACTION AND CONTACTS**

Date of Approval by Section Executive Committee (the “Executive Committee”):  
Approval Vote:

For: \_\_\_ Against: \_\_\_

Date of Approval by Legislative Subcommittee of the Executive Committee:  
Approval Vote:

For: \_\_\_ Against: \_\_\_

Date of Approval by the Insolvency Law Committee:  
Approval Vote:

For: \_\_\_ Against: \_\_\_

Date of Approval by the Legislative Subcommittee of the Insolvency Law Committee: June \_\_, 2018

Approval Vote:

For: 3 Against: 0

<b>Executive Committee Contact:</b>	<b>Insolvency Law Committee Contact:</b>
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**HISTORY, DIGEST AND PURPOSE**

The Insolvency Law Committee seeks to promote predictability, efficiency and consistency in the administration of the federal and California laws governing insolvency and the rights and duties of creditors and debtors. The Committee evaluates and advocates changes in federal and state statutes and regulations affecting creditors and debtors. This Legislative Proposal is consistent with the Committee's mission because the proposed amendment to the statute will cure a defect that renders the statute both illusory and contrary to the underlying policy of the homestead exemption.

Currently, a judgment debtor in California can exempt between \$75,000 to \$175,000 in equity in a home under California Civil Code section 704.730<sup>1</sup>, the homestead exemption. Civil Code Section 704.720(b) requires the judgment debtor to reinvest the amount exempted in a new homestead within six months.

In bankruptcy, a debtor subject to a forced home sale that receives the homestead exemption, usually cannot reinvest the exemption proceeds within six months for a variety of reasons: (1) the homestead exemption has not been increased in years, and past increases are not commensurate to inflation or housing prices, making the purchase – or even the down payment – of a new home in California with the exemption nearly impossible; (2) debtor's credit score and loan underwriting requirements make purchasing a new home within six months of bankruptcy not feasible; (3) many debtors using the homestead are at later stages in their careers with the homestead the only remaining significant asset, yet reinvesting is not usually feasible resulting in a loss of an expected retirement vehicle, and; (4) it literally renders some debtors homeless.

The proposed amendment removes the six-month reinvestment requirement when the homestead exemption is claimed in bankruptcy; it does not alter forced sales outside of bankruptcy. Given that reinvestment for a bankrupt debtor in six months is a near impossibility, the homestead exemption is currently rendered illusory in Title 11 cases.

### **History.**

Enacting a working homestead exemption law is directed by the California Constitution. "The Legislature shall protect, by law, from forced sale a certain portion of the homestead and other property of all heads of the families." Cal. Const. Art. XX, § 1.5.

The homestead exemption's purpose is straightforward: "The object of all homestead legislation is to provide a place for the family and its surviving members, where they may reside and enjoy the comforts of a home, freed from any anxiety that it may be taken from them against their will, either by reason of their own necessity or improvidence, or from the importunity of their creditors." *Thornsby v. Babcock*, 36 Cal.2d 202, 204 (1950), quoting *In re Estate of Fath*, 132 Cal. 609, 613 (1901). "[T]he homestead law is not designed to protect creditors, but protects

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<sup>1</sup> CCP § 704.730 is part of the "automatic homestead" provisions contained in §§ 704.710-704.850. This proposal does not consider CCP §§ 704.910-704.995 that covers a "declared homestead."

the home against creditors . . . thereby preserving the home for the family.” *Amin v. Khazindar*, 112 Cal.App.4th 582, 588 (2003).

The six-month reinvestment requirement was intended to inhibit a debtor’s use of “proceeds to the detriment of creditors and without the benefit to his family which the statute was designed to protect.” *Thornsby v. Babcock*, 36 Cal.2d at 205. *Thornsby* goes so far as to cite a law review article that “severely criticizes” homestead exemptions without a reinvestment requirement. *Id.*

The six-month reinvestment problem came into sharp focus for California residents in the Ninth Circuit case *Wolfe v. Jacobson (In re Jacobson)*, 676 F.3d 1193 (9th Cir. 2012). In *Jacobson*, a debtor filed Chapter 7 bankruptcy after nearly three decades of litigation with a creditor. Creditor moved for relief from the automatic stay, and forced the sale of debtor’s home while in bankruptcy. Debtor claimed, and was paid her \$150,000 homestead exemption, but failed to reinvest it within six months. The \$150,000 was found to be unexempt for failure to reinvest, and subject to turnover to the trustee to pay for administration of the bankruptcy estate and payment to creditors.

This result came to be known in the insolvency world as the “*Jacobson* problem,” though it has been a long-standing issue with some lower courts finding policy arguments to circumvent this result. *Jacobson* rejected policy arguments advanced by other courts, including the Ninth Circuit Bankruptcy Appellate Panel, that the “fresh start” principles of bankruptcy and similar arguments overcame the statutory six-month reinvestment requirement.

Since debtors in bankruptcy have poor credit, and most underwriting prohibits lending to a bankruptcy party in Chapter 7 for four years (or two years for “extenuating circumstances”), it leads to a loss of the homestead, or some creative attempts to preserve for the homestead. For example, in *In re Sain*, 2018 LEXIS 1396 (Bankr. SD CA 2018), a debtor used his \$75,000 homestead exemption toward a leasehold purchase. The Chapter 7 trustee argued that debtor was required to have title, and thus a leasehold did not meet the homestead exemption requirement. The court found in favor of debtor, but this was just one bankruptcy court, dealing with the forced “creative” measures a debtor must undertake to try to preserve a homestead exemption in California since reinvestment in six-months is not possible in nearly all cases.

#### **Relevant Existing Code Sections.**

California Civil Code section 704.730 permits a judgment debtor to claim \$75,000 to \$175,000 in equity in their home. A single person can claim \$75,000; a family can be entitled to \$100,000; if age, or disability, or income requirements are met, a homestead exemption for \$175,000 can be claimed.

704.720(b) requires the judgment debtor to reinvest the amount exempted in a new homestead within six months. This proposal only seeks to change the six-month reinvestment requirement under 704.720(b).

**Proposal.**

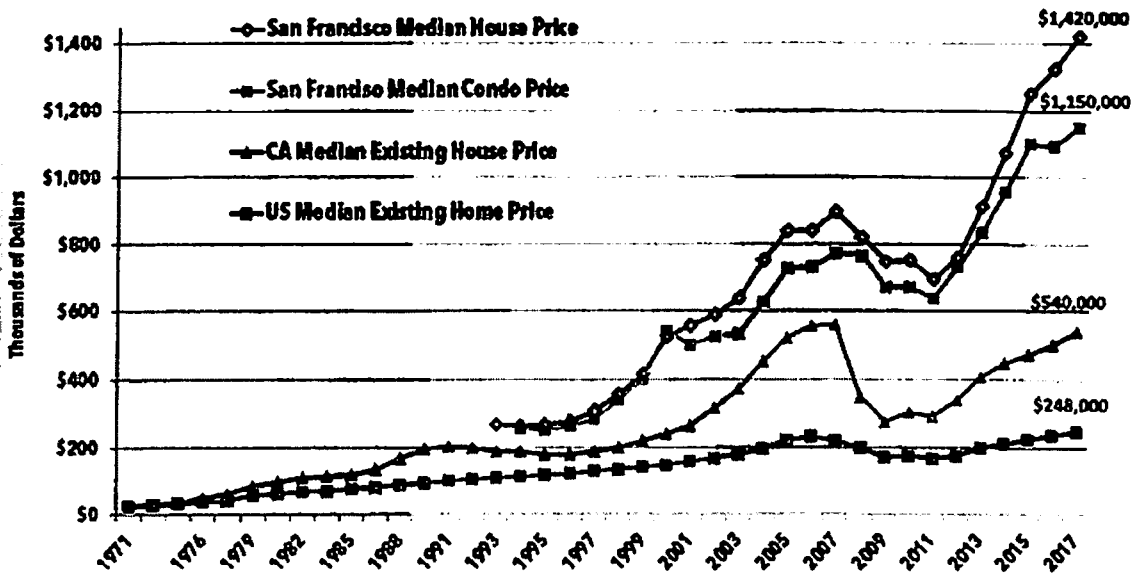
This Legislative Proposal amends California Civil Code section 704.720(b) that currently requires judgment debtors to reinvest their homestead proceeds within six months into another home. The proposal is narrowly tailored, seeking an exemption from the six-month reinvestment requirement when the judgment debtor has filed bankruptcy; the reinvestment period is not altered for forced sales outside of Title 11 of the United States Code.

**Reasons for the Proposal.**

The six-month reinvestment requirement presents debtors in bankruptcy with an often-impossible requirement. While they can claim a homestead exemption, reinvesting within the six-month window is not feasible.

First, the amount of the homestead exemption requires some parity with home prices and inflation in order for reinvestment within six months to happen. For a typical family unit, \$100,000 does not come close to the median price of a home in California. The median price of a home in California far exceeds \$500,000, rendering the homestead exemption unusable for purchasing a new home. It does not even meet the median U.S. price of nearly \$250,000.

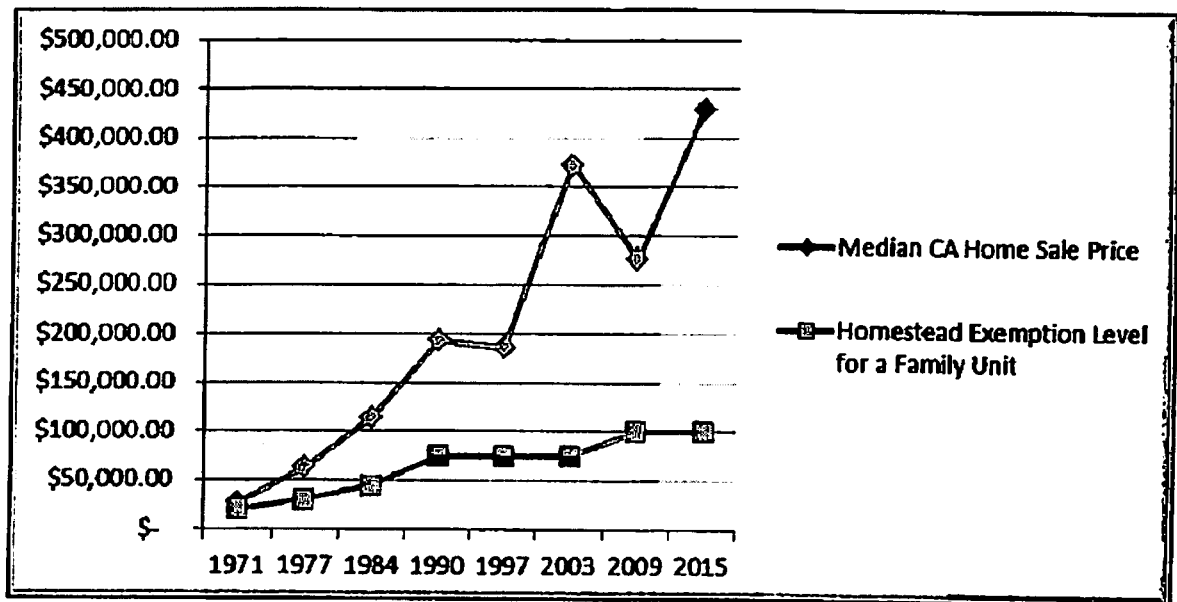
**Median Home Sales Prices by Year  
 San Francisco, CA and U.S. Trends**



Data from the San Francisco, East Bay, California and National Associations of Realtors: deemed reliable but may contain errors and is subject to revision. All numbers are approximate. 2017 CA and US medians are estimates based on an average of monthly median sales prices.



When SB 308<sup>2</sup> was introduced in 2015, this simple chart was used to show the continuing separation between the homestead exemption and home values.



The disparity between equity and the homestead exemption has only grown farther apart. The further the homestead exemption gets from true home prices, the more unrealistic a six-month reinvestment requirement becomes.

Second, current loan underwriting makes obtaining a loan within six months of bankruptcy impossible. FannieMae and FreddieMac that back most loans obtained in the United States explicitly prohibit backing loans for anyone that filed bankruptcy in the past two years for any bankruptcy. Chapter 7, where most forced sales would happen, has a four-year prohibition. If there are "extenuating circumstances," it is reduced to two years.

[https://www.fanniemae.com/content/fact\\_sheet/derogatory-credit-event-fact-sheet.pdf](https://www.fanniemae.com/content/fact_sheet/derogatory-credit-event-fact-sheet.pdf) This makes reinvesting within six months a near impossibility for most borrowers.

Third, it is not uncommon for a debtor that loses a home through a forced sale to be at or near retirement age. The home is often the only remaining significant asset. Loss of the homestead exemption for failure to reinvest prevents a significant hardship.

<sup>2</sup> California Senate Bill 308 contained numerous proposed amendments to California's exemptions and statutes that affect bankruptcy.

Fourth, the homestead exemption is intended to ensure families do not become homeless. Given the extreme difficulty that the reinvestment requirement presents debtors, the policy underlying the homestead exemption is defeated.

#### **APPLICATION**

The amendment in this Legislative Proposal should take effect on January 1 of the calendar year immediately following its adoption. It is unnecessary for it to have any retroactive effect.

#### **PENDING LITIGATION**

None.

#### **LIKELY SUPPORT AND OPPOSITION**

Homeowners and the debtors' bar supports this. Bankruptcy trustee may oppose, though an informal survey has indicated trustees are generally neutral. The group most likely to oppose the statute are creditors that would lose the ability to take advantage of the now-dysfunctional interaction between the homestead and reinvestment requirement.

#### **FISCAL IMPACT**

None.

#### **GERMANENESS**

This Legislative Proposal is germane to the mission of our Committee because its adoption will rectify an insolvency statute that no longer fulfills the underlying policy it was intended to promote. The mechanics between obtaining a homestead exemption, paired with the requirement to reinvest in another homestead within six months does not work, and has not worked for some time. The homestead has not been increased commensurately to the home values in California, and has not even tracked the median home values of homes outside of California. This, together with the stricter underwriting requirements, makes reinvestment of the homestead exemption illusory, resulting in a loss of the exemption.

#### **TEXT OF PROPOSAL**

The proposed text is taken from part of SB 308. SB 308 follows the original text of 704.720, and adds an exception for judgment debtors that file under Title 11. It makes some organizational changes, but keeps the same text, except for the Title 11 exception. The substantive change is underlined.

**ORIGINAL TEXT: 704.720.**

(a) A homestead is exempt from sale under this division to the extent provided in Section 704.800.

(b) If a homestead is sold under this division or is damaged or destroyed or is acquired for public use, the proceeds of sale or of insurance or other indemnification for damage or destruction of the homestead or the proceeds received as compensation for a homestead acquired for public use are exempt in the amount of the homestead exemption provided in Section 704.730. The proceeds are exempt for a period of six months after the time the proceeds are actually received by the judgment debtor, except that, if a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during that period, the proceeds thereafter are not exempt.

(c) If the judgment debtor and spouse of the judgment debtor reside in separate homesteads, only the homestead of one of the spouses is exempt and only the proceeds of the exempt homestead are exempt.

(d) If a judgment debtor is not currently residing in the homestead, but his or her separated or former spouse continues to reside in or exercise control over possession of the homestead, that judgment debtor continues to be entitled to an exemption under this article until entry of judgment or other legally enforceable agreement dividing the community property between the judgment debtor and the separated or former spouse, or until a later time period as specified by court order. Nothing in this subdivision shall entitle the judgment debtor to more than one exempt homestead. Notwithstanding subdivision (d) of Section 704.710, for purposes of this article, "spouse" may include a separated or former spouse consistent with this subdivision.

**PROPOSED CHANGE 704.720.**

(a) A homestead is exempt from sale under this division to the extent provided in Section 704.800.

(b) (1) If a homestead is sold under this division or is damaged or destroyed or is acquired for public use, the proceeds of sale or of insurance or other indemnification for damage or destruction of the homestead or the proceeds received as compensation for a homestead acquired for public use are exempt in the amount of the homestead exemption provided in Section 704.730 for a period of six months after the time the proceeds are actually received by the judgment debtor, except as provided in paragraph (2).

(2) If a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during the six-month period described in paragraph (1), the proceeds thereafter are not exempt.

(3) In a case under Title 11 of the United States Code, regardless of whether the sale is voluntary or involuntary, the expiration of the six-month period described in paragraph (1) at any time after the filing of the case shall not terminate the exempt status of the homestead or its proceeds.

(c) If the judgment debtor and spouse of the judgment debtor reside in separate homesteads, only the homestead of one of the spouses is exempt and only the proceeds of the exempt homestead are exempt.

(d) (1) If a judgment debtor is not currently residing in the homestead, but his or her separated or former spouse continues to reside in or exercise control over possession of the homestead, that judgment debtor continues to be entitled to an exemption under this article until entry of judgment or other legally enforceable agreement dividing the community property between the

judgment debtor and the separated or former spouse, or until a later time period as specified by court order.

(2) Nothing in this subdivision shall entitle the judgment debtor to more than one exempt homestead.

(3) Notwithstanding subdivision (d) of Section 704.710, for purposes of this article, "spouse" may include a separated or former spouse consistent with this subdivision.



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**SUPPLEMENTAL CONTACTS INFORMATION**

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Committee, State Bar of California Business Law Section  
Legislative Proposal 2018  
[date]