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The Texas Homestead: The Last Bulwark of Liberty Forum.

Henry B. Gonzalez

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THE TEXAS HOMESTEAD: THE LAST BULWARK OF LIBERTY

HENRY B. GONZALEZ*

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I. INTRODUCTION

The Texas Constitution contains many rights and liberties for the protection and benefit of the state's citizens that reflect the specific influences of events, cultures, and individuals on the development of legal principles and political values in the state. Unique among these treasured liberties is the protection of a person's homestead from forced sale or foreclosure by creditors.¹ For more than 155 years and across numerous generations, Texans have adamantly supported the principle that the fundamental need for shelter justifies strict constitutional protection of homes from creditors in all but a few situations.²

The cherished home equity protection has been under sustained attack for several years by a group of bankers and other financiers for whom a homestead is nothing more than a type of collateral and another potential source of profit. Not surprisingly, this group

* Member, United States House of Representatives (D-Tex.); J.D., St. Mary's University School of Law. Congressman Gonzalez was first elected to public office in 1953 as a member of the San Antonio City Council, on which he served until 1956. From 1957 to 1961, he served as a member of the Texas Senate. In 1961, Congressman Gonzalez resigned his position as state senator to run for the United States House of Representatives, where he has continuously served since that year. From 1989 to 1994, he chaired the House Committee on Banking, Finance, and Urban Affairs, a position he has held since 1989.

1. TEX. CONST. art. XVI, § 50.

2. The Texas Constitution allows foreclosure only in the case of a first mortgage, a home improvement loan, or a tax lien. *Id.*

is led by bankers from outside the state who have little regard for the unique history, traditions, and values of Texas and its citizens.

The homestead debate does not merely involve whether Texans should be allowed to obtain certain types of home equity loans; rather, it centers around the protection of families from homelessness during hard times or personal hardships. Indeed, many Americans today live only one or two paychecks away from poverty and homelessness. If the homestead protection were repealed, any creditor could foreclose on a family's home for any debt, including those involving credit cards, jewelry, or furniture. A family must have protection against homelessness if it suddenly cannot pay all its bills because of illness, temporary unemployment, or other reasons.

Recently, in *First Gibraltar Bank, FSB v. Morales*,³ opponents of the homestead liberty convinced a panel of the United States Court of Appeals for the Fifth Circuit that an Office of Thrift Supervision⁴ regulation preempts the Texas Constitution.⁵ The court's opinion clearly was result-oriented and was intended as an attack on the homestead liberty itself. As chairman of the committee having jurisdiction over this matter in the United States House of Representatives, I immediately implemented a plan to overrule this flawed decision through federal legislation. With the overwhelming support of my House and Senate colleagues, and in an attempt to preserve the Texas homestead exemption, I took the extraordinary step of attaching a corrective amendment to a bill authorizing interstate branching. At that time, the bill was in conference and therefore already near the end of the legislative process. That bill, with the amendment attached, became law on September 28, 1994.⁶ Five days later, the United States Supreme Court, recognizing that *First Gibraltar Bank* had become moot, refused to hear the case.⁷

3. 19 F.3d 1032 (5th Cir.), *cert. denied*, 115 S. Ct. 204 (1994), *vacated with substitute opinion*, 1995 U.S. App. LEXIS 251 (5th Cir. Jan. 4, 1995).

4. The Office of Thrift Supervision is the federal agency responsible for regulating state and federally chartered savings associations and certain savings banks.

5. *First Gibraltar Bank*, 19 F.3d at 1053.

6. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 102(b)(5), 108 Stat. 2338 (1994) (amending Home Owners' Loan Act of 1933, 12 U.S.C. § 1462(a) (1989)).

7. *See Morales v. First Gibraltar Bank, FSB*, 115 S. Ct. 204 (1994) (denying certiorari).

As a lifelong student of history, I was able to provide my colleagues on the House and Senate Conference Committee with a historical analysis of the Texas homestead liberty and an explanation of the popular sentiment that has kept the liberty sacrosanct throughout the state's history. I restate and build on those remarks here to remind all Texans from whence the homestead protection came and why it should not be lightly discarded, despite the blandishments of those who value short-term profit far more than the personal security of Texas consumers.

II. HISTORICAL ANALYSIS

The homestead liberty in Texas law dates back to the first days of the Texas Republic. In 1839, the Congress of the Republic of Texas enacted the first homestead law for the protection of the Republic's citizens.⁸ The homestead exemption was then included in the 1845 constitution adopted when the Republic joined the Union.⁹ With recognition and protection of the liberty well encrusted in every Texas Constitution since then,¹⁰ Texans have enjoyed this liberty and have had their homes protected for more than 155 years.

Soon after Texas adopted its constitutional homestead exemption, other states followed suit. In 1849, Vermont became the second state to incorporate the homestead liberty into its constitution.¹¹ Later, other states enacted similar provisions.¹² Currently, about half the states, mostly in the Midwest, South, or West, provide some type of constitutional homestead protection.¹³

What motivated our Texas forefathers to grant constitutional recognition and protection to the homestead? The answer illumi-

8. Act approved Jan. 26, 1839, 3d Cong., R.S., 1839 Republic of Texas Laws 125, 125-26, reprinted in 2 H.P.N. GAMMEL, LAWS OF TEXAS 125, 125-26 (1898).

9. TEX. CONST. of 1845, art. VII, § 22.

10. See ALOYSIUS A. LEOPOLD, HOMESTEADS AND MARITAL PROPERTY IN TEXAS 1 (5th ed. 1994) (recognizing guarantee of homestead exemption in 1845 Texas Constitution and noting that exemption has been carried forward and re-enacted in every subsequent state constitution).

11. Brady Cole, *The Homestead Provisions in the Texas Constitution*, 3 TEX. L. REV. 217, 233 n.74 (1925).

12. See *id.* (recognizing that, after Vermont, many southern and western states adopted homestead doctrine in their constitutions).

13. 2 GEORGE D. BRADEN ET AL., THE CONSTITUTION OF THE STATE OF TEXAS: AN ANNOTATED AND COMPARATIVE ANALYSIS 789-90 (1977).

nates why our fierce and widely held belief in this cherished liberty is as fervent today as it was 155 years ago.

First, the declaration of the homestead liberty reflects the unique influence of Spanish and Mexican legal traditions on our laws and values. Texas was originally governed by Spanish colonial law, and then by Mexican law, before it established its independence from the Republic of Mexico. As a result of the Mexican and Spanish influence, Texas laws took a more compassionate approach to individual needs than the Anglo-Saxon or common laws. For example, in the area of domestic relations, Spanish and Mexican laws granted a wife a one-half interest in the property of her husband; in contrast, Anglo-Saxon law and the common law considered the wife little more than her husband's chattel.¹⁴ Spanish and Mexican laws also gave greater protection to debtors by allowing them to prevent creditors from seizing the home, clothing, and tools a person needed to survive.

Second, the homestead liberty, like the rest of our original laws, reflects the values of the great Texas pioneers, who drew from their experiences and hardships in drafting our state constitution. The Texas pioneers came from Tennessee, Kentucky, and Georgia, among other states, many of them fleeing creditors who would force them into homelessness without any means of sustenance. In fact, in the master deed records of many Tennessee counties, one may still find a notation, entered by a sheriff who was unable to serve a summons on a debtor, reading simply "GTT"—gone to Texas. Moreover, the pioneers came to Texas homeless, carrying their sparse belongings in covered wagons. After suffering and fighting for freedom and independence, the pioneers made sure that the laws of the new Republic would reflect their values, priorities, and experiences. Foremost among these was the protection of a person's home.

The Panic of 1837 also had a strong influence on the Texas pioneers. In the 1830s, as has been repeated many times over suc-

14. See Susan Klebanoff, Comment, *To Love and Obey 'til Graduation Day—The Professional Degree in Light of the Uniform Marital Property Act*, 34 AM. U. L. REV. 839, 841 n.14 (1985) (distinguishing civil law system of Spain, which recognized marriage as legal entity distinct from those who formed it, from common law system, which recognized marriage as merger of husband and wife into one); see also Neal Devins, *Gender Justice and Its Critics*, 76 CAL. L. REV. 1377, 1402 (1988) (book review) (recognizing common-law doctrine that classified wife as husband's chattel).

ceeding decades, excessive speculation and questionable bank practices resulted in financial collapse. The economy went into a tailspin and many innocent families lost their homes through foreclosure. When events beyond the control of average citizens, such as the Panic of 1837, threaten health and safety, representative governments must enact some basic protections. This premise is the foundation of the Texas constitutional homestead protection.

Indeed, even though the impoverished Texas treasury could not make change for a fifty dollar bill, and despite the overwhelming fear of a Mexican re-invasion, Texans' first priority after gaining independence was to secure and protect their most basic liberties. In addition to protection of the home, our Texas forefathers set aside the vast realm known as the public domain and dedicated it to provide every person with a public education. If profiteers and provocateurs are allowed to take our homes, would they then set their sights on the public lands and the education of our youth?

The federal government also began to establish some protections for the homestead. In 1862, Congress passed the National Homestead Act,¹⁵ which provided settlers of the American West with the means to obtain legal title to a plot of federal land for the purpose of setting up a home. Congress, recognizing the importance of protecting a homesteads from creditors, provided that homesteads acquired under the Act could not be claimed by creditors for the satisfaction of prior debts. Unfortunately, many of these public lands ended up in the hands of land speculators and railroad barons.

Consistent with the Mexican tradition of protecting the elements of livelihood, the Texas homestead exemption also extends to farms and farm implements. Thus, the case of a farmer losing his land, not because he could not pay the mortgage, but because he could not make his payments on a loan for seed, would not occur in Texas. Without the homestead liberty, farmers, ranchers, businesspersons, and consumers would be forced to pledge their homes as collateral for any type of loan.

The circumstances surrounding the adoption of the Texas Constitution illustrate why the homestead liberty remains so revered to this day. In a world in which land was cheap and plentiful, but debt

15. Act of May 20, 1862, ch. 75, 12 Stat. 392 (repealed 1976).

an ever-present threat to a hard-won home and plot of ground, the homestead exemption became the only sure means of protecting homes, farms, and ranches against human predators who otherwise might have seized assets that had been wrested from the wilderness and protected despite storm, drought, or flood. The wisdom and values of the Texas pioneers have proven themselves for more than 155 years and will continue to endure.

III. PROTECTION AGAINST UNSCRUPULOUS LENDERS

The constitutional homestead exemption has served as a valuable protection for Texas citizens from the many unscrupulous creditors who would use all legal, illegal, and in-between means to take our homes and make a "fast buck."

In states with no history of homestead protections, creditors have developed new gimmicks concerning mortgage arrangements and home equity loans. Some of these loan arrangements are specifically targeted at the elderly. The sales pitch involves convincing elderly people that they are "home rich but cash poor" and implying that, since they do not have long to live, they can "cash in" on the value of their home and never have to repay the loan. However, is there any doubt that the creditor will foreclose on the home at the first opportunity? Absolutely not.

As chairman of the House Committee on Banking, Finance, and Urban Affairs, I have heard heartrending testimony from people who have, in essence, had their homes stolen by predatory home equity lenders acting within the literal fringes of the law.¹⁶ Their horror stories illustrate the wisdom of retaining Texas's broad constitutional homestead protection.

The House Banking Committee has ample evidence that lenders often use abusive, predatory mortgages to take advantage of unsophisticated, low-income homeowners who lack access to legitimate

16. See generally *Home Equity Protection Act of 1993: Hearing on H.R. 3153 Before the Subcomm. on Consumer Credit and Ins. of the House Comm. on Banking, Finance, and Urban Affairs*, 103d Cong., 2d Sess. (1994) [hereinafter *Subcommittee Hearing*]; *Home Ownership and Equity Protection Act of 1993: Hearing on S. 924 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong., 1st Sess. (1993) [hereinafter *Senate Hearing*]; *Rhode Island Banking Crisis: Field Hearing Before the House Comm. on Banking, Finance, and Urban Affairs*, 102d Cong., 1st Sess. (1991) [hereinafter *Field Hearing*].

sources of credit.¹⁷ Generally, these homeowners have developed equity in their homes as the result of paying down first mortgages or because of the appreciation of real estate over their lifetimes. Despite this equity, the owners' incomes are often limited. In fact, several victims of high-rate home equity loan scams lived solely on Social Security.¹⁸ Nevertheless, lenders employed high-pressure sales tactics to convince these borrowers that they could afford mortgage payments that sometimes equaled or exceeded their entire monthly income. Such hapless borrowers must then sacrifice other necessities, such as medical treatment, to meet their mortgage payments. In the worst-case scenario, the borrower falls further behind on their payments, eventually losing the home.

Second mortgages are sometimes characterized by price gouging through excessively high interest rates, high fees, and penalty features, which cause the loan to grow beyond the lender's actual investment. In one case, \$23,433 of a \$52,010 loan was applied to fees, prepaid interest, and a lender-required repair fund; the borrower paid additional fees of \$6,985 for mortgage-broker and loan-origination fees.¹⁹

Predatory lenders need not be concerned about loan performance or underwriting standards because they have the ultimate security—the borrower's home.²⁰ In a sad but all-too-common case, a lender persuaded a retired couple in Massachusetts, a state without a homestead protection, to take out a \$147,000 second mortgage on their home. The mortgage contract required monthly payments of \$2,800, even though the couple's Social Security income—their only source of income—was just \$1,000 a month. Needless to say, the couple fell behind on their payments, resulting

17. See *Subcommittee Hearing*, *supra* note 16, at 3 (testimony of Kathleen Keest, National Consumer Law Center, regarding people who would benefit from bill); *Senate Hearing*, *supra* note 16, at 66 (statement of Emilio Vigil, homeowner, discussing his layoff and his wife's disability); *Field Hearing*, *supra* note 16, at 307 (statement of William E. Robinson, as provided by his attorney, Dianne Wilkerson, reporting his parents' inability to obtain traditional loan).

18. See *Field Hearing*, *supra* note 16, at 307 (statement of William E. Robinson, as provided by his attorney, Dianne Wilkerson); *Senate Hearing*, *supra* note 16, at 66 (statement of Emilio Vigil).

19. *Senate Hearing*, *supra* note 16, at 67 (statement of Barbara A. Isenhour, attorney with Evergreen Legal Services).

20. *Subcommittee Hearing*, *supra* note 16, at 8 (testimony of Kathleen Keest, National Consumer Law Center).

in foreclosure proceedings. When the couple's outraged son confronted the lender and asked why the lender extended credit with payments in excess of his parents' ability to pay, the lender responded that the home securing the loan was more valuable than the loan.²¹ Thus, the lender was fully secured. What often follows is a foreclosure action by the lender, who then purchases the property at a distressed price and completes the scam by selling the home at market price for a hefty profit.

The Committee also learned of finance companies that deliberately target people who are unable to pay their property taxes. The companies tell the homeowners that the state will take their home if they do not pay their taxes, then generously offer to extend credit without setting income requirements or credit limits. Of course, these loans are made at three to four times the market rate and are padded with excessive fees.

Consider also the story of a family that owed only \$11,000 on their mortgage. Disability forced the family to rely on a caretaker to pay their bills, but the caretaker failed to do so. In 1992, the family contacted a mortgage broker to obtain a second mortgage to cure the delinquency on their first mortgage. The terms of the second mortgage include an 18.5 percent interest rate and monthly payments of \$650; however, the family's joint monthly income is only \$860 before taxes. As is often the case, the monthly payments are less than the accruing interest on the loan, so a balloon payment of \$52,000 will be due at the end of the three-year loan term.²² Needless to say, the family will be unable to meet the terms of the second mortgage and will likely lose their home to the mortgage company through foreclosure.

I do not mean to suggest that all home equity loans are inherently bad or to characterize all home equity lenders as predatory. However, as evidenced by the cases above, such loans do lend themselves to abuse. Texans should be proud that we have prevented many of these unconscionable practices by maintaining the homestead liberty. No better consumer protection device exists.

21. See *Field Hearing*, *supra* note 16, at 307 (statement of William E. Robinson, as provided by his attorney, Dianne Wilkerson).

22. *Senate Hearing*, *supra* note 16, at 66-67 (statements of Barbara A. Isenhour and Emilio Vigil).

Nevertheless, Texans are by no means immune to corrupt lending practices, even with respect to first mortgages. Recently, many Texans have been victimized by infamous contract for deed arrangements. Under a contract for deed, a person agrees to make monthly payments to the developer who owns the land for a fixed number of years. Upon making the last payment, the borrower receives title to the home and the land upon which it sits. Unlike a transaction involving a warranty deed, however, a person builds no home equity in a contract-of-sale arrangement.

Historically, unscrupulous developers frequently used contracts for deed to sell land to low-income individuals, who were easy prey since they did not have traditional lines of credit available to them. The lots were usually located in areas that had been "redlined"²³ by banks and other legitimate lenders. This corrupt practice frequently led to harsh results. For instance, families often lost their homes after missing one payment over ten years. Additionally, many developers collected payments and then defaulted on their own loans, which were secured by the very same lots under sale by a contract for deed. Innocent families were forced out of their homes when the developer's creditors sought to foreclose on their collateral, even though the family had faithfully paid every installment due under the contract. I fought for years, unfortunately with no success, to have state laws enacted prohibiting these contracts.

Furthermore, during my first year in the Texas Senate, I filibustered against a bill that would have authorized lenders to charge more than 320 percent interest on small loans. Texans have always been subjected to these types of abusive financial practices, contributing to Texas's reputation as the "Loan Shark State" rather than the Lone Star State. Little wonder that Texans hold firmly to their homestead protections. All Americans would be well served by the same homestead liberty that Texans now enjoy.

IV. IMPACT OF HOMESTEAD PROTECTION DURING THE 1980s

To appreciate the contemporary significance of the Texas homestead liberty, one need only look to the experience of the 1980s. The 1980s were a time of both boom and bust. A strong local econ-

23. Redlining is the illegal practice of denying loans or other financial services to individuals simply because they reside in certain geographic areas of a city, usually those areas primarily inhabited by low-income families or minority groups.

omy and inflation allowed Texans to build up a fast 30 to 40 percent equity position in their homes. However, by 1986, the recession hit Texas hard. Though tens of thousands of families lost their homes through foreclosure during the bust,²⁴ some experts have estimated that foreclosures would have quadrupled without the homestead exemption,²⁵ as equities evaporated and property values fell far below the debt charged against them.

Without the homestead protection, Texans could have easily found themselves in the same dire situation that the citizens of California have endured. Like Texans, Californians enjoyed a robust economy during the early 1980s and the value of their homes skyrocketed. However, unlike Texans, many Californians took out huge home equity loans for such things as vacation homes and fancy cars, borrowing up to the usual limit of 90 percent of their home equity.

As the California economy plummeted into a recession, those easy, seductive home equity loans revealed the real estate market as the most vulnerable and hardest hit sector of the economy. Banks were left holding undercollateralized, delinquent, and defaulted loans. In fact, one commentator described the spending of home equity loan proceeds as artificially bloating the regional economy, "thereby causing it to burst like a bubble when deflation hit."²⁶ California has not yet recovered from the recession of the 1980s. With \$255 billion in home equity loans outstanding nationwide, this hardship is bound to repeat itself in one or more other states with the next economic downturn.

The contrast with the California experience is only a recent example of how the homestead liberty has protected Texans. Over the past 150 years, the homestead liberty has shielded vast numbers of our families from homelessness throughout other recessions and depressions. Such protection is no doubt the reason why the late Judge John Dillon asserted that "the legal concept of a homestead

24. According to the National Mortgage Bankers Association, from 1987 to 1990, the foreclosure rate in Texas exceeded that of the rest of the nation by almost 50%.

25. *Hearing Before the Senate Interim Comm. on Home Equity Lending*, 103d Cong., 1st Sess. 2 (1993) (statement of Parker McCullough, Vice President of Governmental Affairs, Texas Association of Realtors).

26. Jim Carlton, *Housing Cave-In: Continuing Home-Price Declines Rattle Southern California and Affect U.S. Recovery*, WALL ST. J., Oct. 13, 1992, at A14.

must be taken as the greatest single contribution of Texas to the onward march of civilization."²⁷

V. CONCLUSION

Our constitutional homestead protection represents the last bulwark of liberty for our freeborn yeomanry, who today have fewer and fewer protections against economic tyranny. Unless we continue to fight to preserve our homestead liberty, we will be a land of homeless, rootless people—refugees in our own land.

In every session of the state legislature since I took my seat in the Texas Senate in 1957, some attempt has been made to repeal the constitutional homestead liberty. The legislature rejected those attempts every time and, in fact, strengthened the homestead provision in a 1973 constitutional amendment. Today, once again, usurious hands are knocking on our doors, anxious to take our homes, as they sought to take our parents' homes and will seek to take our children's homes. The Texas Constitution has stood firmly in their path for 150 years. Now, with the lure of easy money, lenders ask us yet again to surrender the liberty for which our forefathers fought and died. This liberty meant everything to our families many generations past, and it will mean everything to our children in the future. It may sometimes be inconvenient to be real-estate rich yet cash poor, but it would be far worse to be overly indebted and homeless. Texans' response to these would-be profiteers must be a loud, proud "Never!"

27. See Brady Cole, *The Homestead Provision in the Texas Constitution*, 3 TEX. L. REV. 217, 233 (1925) (paraphrasing reported statement of Judge Dillon).