CLIENT MEMORANDUM

From: PeirsonPatterson, L.L.P.

Date: December 11, 2014

Subject: Spousal Signature Requirements on a Note and Deed of Trust secured by Texas Real Property

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We are providing our clients with this memo to evidence this firm's opinion on joinder requirements in Texas of non-applicant spouses in secured loan transactions. As discussed below, joinder requirements for the note and deed of trust are governed both by the Equal Credit Opportunity Act (ECOA) and Texas law.

ECOA

Whether a lender may require both spouses to sign a note in a residential mortgage transaction is largely governed by the ECOA, Reg. B §§ 202.7(d)(4) and (5), and the commentary relating to those particular Sections.

§202.7(d)(4) references the legal necessity for the non-applicant spouse to sign the note, and states:

> "*Secured credit*. If an applicant requests secured credit, a creditor may require the signature of the applicant's spouse or other person on any instrument necessary, or reasonably believed by the creditor to be necessary, under applicable state law to make the property being offered as security available to satisfy the debt in the event of default, for example, an instrument to create a valid lien, pass clear title, waive inchoate rights or assign earnings.";

and the commentary for §202.7(d)(4) states:

1. "*Creation of enforceable lien.* Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require them to do so."

2. "*Need for signature – reasonable belief.* Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that to assure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general."

3. "*Integrated instruments.* When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be required to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear – for example, by a legend placed next to the spouse's signature – that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability."

§202.7(d)(4) permits lenders to require the non-applicant spouse to execute only documents necessary to create an enforceable lien. It does not specifically mention the note, yet the related commentary does. The commentary states that a lender may not require a non-applicant spouse to sign the note unless under state law this signing is necessary to create an enforceable lien. No such law exists in Texas.

§202.7(d)(5) states:

> "*Additional parties.* If, under a creditor's standards of creditworthiness, the personal liability of an additional party is necessary to support the extension of the credit required, a creditor may request a cosigner, guarantor, or the like. The applicant's spouse may serve as an additional party, but the creditor shall not require that the spouse be the additional party.";

and the commentary for '202.7(d)(5) states:

> "*Reliance on income of another person – individual credit.* An applicant who requires individual credit relying on the income of another person (including a spouse in a non-community property state) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states the signature of a spouse may be required if the applicant relies on the spouse's separate income. If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so – even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse."

§202.7(d)(5) prohibits a lender from requiring the non-applicant spouse to be personally liable for the debt when the credit, income and other financial criteria of only the borrower is considered necessary for the loan. The spouse may be required to sign the note only if his or her separate income and future earnings are necessarily relied upon by the lender for repayment of the loan.

<u>Texas Law</u>

With regard to a Texas deed of trust, a lender may require joinder of the applicant's spouse under ECOA §202.7(d)(4) and the related commentary; however, in considering whether or not the joinder is necessary for the creation of a valid lien will depend upon whether or not the property: a) is the homestead of either spouse; b) involves a purchase or refinance transaction; or c) is currently vested in title to both spouses. Three possible situations are analyzed below:

1) *Homestead Property – Purchase Money.*

From a legal standpoint, both signatures are not required in Texas to validate a purchase money lien securing homestead property. *Cannon, et al v. Texas Independent Bank*, Court of Appeals of Texas, 6th Dist., No. 06-98-000175-CV, 8/5/99. Either spouse alone can encumber the homestead for purchase money if that spouse alone takes title to the property. *Leach, et al v. First Fin. Resolution Partners, Inc. et al*, Northern District of Texas No. 3:97-CV-0541-0, 7/11/97. The legal theory is that the vendor's lien takes precedence and is created prior to the homestead vesting in the borrower or the non-purchasing spouse. *Farmer v. Simpson*, 6 Tex. 303 (1851). Borrowers acquire their homestead rights *after*, not before, the purchase money lien has been attached, and the lien continues to be good no matter what factual events later occur. *Skelton v. Washington Mut. Bank, F.A.*, 61 S.W.3d 56, 60 (Tex. App. – Amarillo 2001, no pet.) (holding that an encumbrance existing against property cannot be affected by the subsequent impression of the homestead exemption on the land so as to avoid or destroy pre-existing rights). It is irrelevant that the borrower or his spouse intends to use the property as homestead and makes those intentions known to the lender. The homestead rights still will not attach until after title is acquired. *Jones v. Male*, 26 Tex. Civ. App. 181, 62 S.W. 827 (1901). Even an implied vendor's lien arising in a divorce decree in favor of the selling spouse is superior to the purchasing spouse's claim of homestead. *McGoodwin v. McGoodwin*, 671 S.W. 2d 880, *rehearing denied* (Tex. 1984). In addition, because a vendor's lien is a lien for purchase money, the lien holder is entitled to enforce it and the deed of trust given with it through foreclosure proceedings notwithstanding any homestead claim and such foreclosure will be proper regardless of the property's status as a homestead. *Gregory v. Sunbelt*, 835 S.W. 2d 155, *rehearing denied* (Tex. App. – Dallas 1992); *see also Skelton*, 61 S.W.3d at 60.

2) *Homestead Property – Refinance.*

According to Tex. Const., Art. 16 §50, and Tex. Family Code §§ 5.81 – 5.84, if either spouse occupies the property as his or her homestead the joinder of the other spouse is required to encumber that homestead, whether separate or community property, unless the situation falls within the very narrow list of exceptions provided for in §§ 5.82 – 5.87 of the Texas Family Code. Those exceptions are:

a) the homestead is the separate property of one spouse and the other spouse has been judicially declared incompetent;

b) the homestead is the separate property of one spouse and the other spouse: (1) is incompetent (the statute does not require that he or she be judicially declared in- competent); (2) disappears and his or her location remains unknown to the owner; (3) permanently abandons the homestead and the owner; or (4) permanently abandons the homestead and the spouses are permanently separated (the statute requires the owner to obtain a court order);

c) the homestead is the separate property of one spouse and the other spouse is a prisoner-of-war or is missing-in-action (the statute requires the owner to obtain a court order);

d) the homestead is the community property of the spouses and one spouse has been judicially declared incompetent;

e) the homestead is the community property of the spouses and one spouse: (1) is incompetent (the statute does not require that he or she be judicially declared incompetent); (2) disappears and his or her location remains unknown to the owner; (3) permanently abandons the homestead and the owner; or (4) permanently abandons the homestead and the spouses are permanently separated (the statute requires the owner to obtain a court order);

f) the homestead is the community property of the spouses and one spouse is a prisoner-of-war or is missing-in-action (the statute requires the owner to obtain a court order);

3) Non-Homestead Property – Purchase or Refinance.

According to Tex. Family Code §§5.21 and 5.22, either spouse may purchase and/or refinance property in his or her own name without the joinder of the other spouse. According to §5.24, absent fraud, actual notice, or constructive notice to the contrary, third persons are protected in relying upon presumptions of sole management, control and disposition of the sole spouse which are provided for in §§5.21 and 5.22. However, the presumptions in these Sections would not be effective in a refinance transaction wherein title to the property is vested in both spouses or in a purchase money transaction wherein both spouses will take title on the deed. Those situations would require the joinder of both spouses to the deed of trust.

Conclusion

In summary, although the non-applicant spouse may not be required to sign the note, he or she may be required to sign the deed of trust if his or her joinder is required for the creation of a valid security interest in the property. Based upon our reading of the referenced Texas statutes and case law, and the pertinent sections and related commentary of ECOA, Reg. B, the following is this firm's opinion with regard to the joinder of non-applicant spouses in loan transactions where Texas real property is offered as security for a debt.

1) Joinder of Non-Applicant Spouse to Note:

Not required to perfect the lien and consequently should not be required if the applicant spouse otherwise meets the credit criteria.

2) Joinder of Non-Applicant Spouse to Deed of Trust:

Required in homestead purchase transactions only if non-applicant spouse will vest in title.

Required in homestead refinance transactions (unless exempted under Tex. Family Code 5.82-5.87).

Required in non-homestead purchase transactions only if non-applicant spouse will vest in title.

Required in non-homestead refinance transactions if both spouses are vested in title and the non-applicant spouse does not transfer out of title to the applicant spouse.

This memorandum is for informational purposes only. It is intended for the benefit of our clients and friends in the industry. It is not intended to be considered legal advice for a particular transaction.