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Home Refinancing Can Affect Rights

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Family Law

Family lawyers very often are faced with the task of apportioning the community and separate interests of the parties in the family residence acquired by one of the parties before marriage. The appellate decisions of *In re Marriage of Moore*, 28 Cal.App.3d 366 (1980), and *In re Marriage of Marsden*, 130 Cal.App.3d 426 (1982), have developed the commonly used Moore/Marsden formula in which the fair market value and loan balance as of the date of marriage, date of separation and the date of trial are obtained in order to determine the community interest and separate interest in the residence.

In *Moore*, the date of marriage approximated the date that the residence was acquired. Thus, the case dealt primarily with allocating the community and separate interests in the residence as a function of the down payment and debt service during and after marriage.

Two years later in 1982, the court in *Marsden* was faced with similar facts as in *Moore*, except there existed the additional wrinkle of allocating the community and separate interest in the residence acquired prior to marriage. There had been considerable appreciation in its fair market value from the date of purchase to the date of marriage. The court opined that the spouse who owned the asset prior to marriage was solely entitled to the pre-marriage appreciation.

In 1986, four years after *Marsden*, in *In re Marriage of Frick*, 181 Cal.App.3d 997 (1986), the appellate court applied the Moore/Marsden formula to a commercial building, extending this body of case law to real property other than a family residence. However, *Moore* and *Marsden* and their progeny did not directly involve a refinancing of the residence or improvements to the property subsequent to the date of the marriage. This article will consider the proper application of the case law and the Civil Code to the determination of the community and separate interests in the family residence as a result of refinancing and/or improvements to the property.

Refinancing Before Marriage

If the original loan is paid off before the date of marriage, one could contend that the new loan has become a substitute for the original loan. The problem with this approach is how to handle the principal reduction of the new loan during marriage. The new loan is most likely at a considerably higher amount than the original loan. If one attempts to include the new loan in the calculation of the community interest in the appreciation during marriage, it should be utilized in conjunction with the Moore/Marsden formula.

Under the Moore/Marsden formula, the community interest in the appreciation is ratio of the decrease in principal of the original loan during marriage (the numerator) paid from community sources divided by the original purchase price (the denominator). Furthermore, the Moore/Marsden formula provides for reimbursement to the community for the reduction of the principal loan balance during the marriage.

Changing the Formula

If one modifies the basic format of this equation, it no longer would be a Moore/Marsden calculation. Instead, it would become a new, yet judicially unapproved, estimate of the division of community property. An equitable approach may be to consider the decrease in the principal reduction of the new loan as a substitute for the principal reductions in the original note.

As an alternative, the new loan could be treated like any other premarital debt. Under *In re Marriage of Camire*, 28 Cal.3d 366 (1989), payments made with community funds on pre-marital debts may be gifts to the separate estate; however, in *In re Marriage of Gowdy*, 178 Cal.App.3d 1228 (1986), the husband purchased the residence prior to marriage and had not refinanced it. The court in *Gowdy* refused to follow the *Camire* argument and instead followed *Moore*, holding that the payment of community funds to reduce the encumbrance on separate property, even though done with knowledge and the apparent consent of the other spouse, gave the community a pro tanto interest in that separate property. *Gowdy* was the first case where this dichotomy between the *Camire* line of cases and the Moore/Marsden application was addressed.

Refinancing After Marriage

Under the Moore/Marsden formula, the community is entitled to credit for principal paydowns, after marriage, on the separate debt incurred prior to the marriage to effectuate the purchase. Additionally, a pro tanto share of the appreciation is also allowed to the community based on the fraction that results from using the community principal paydown as the numerator and the purchase price of the residence as the denominator.

What is the proper application of the case law and the Civil Code to the determination of the community and separate interests in the family residence as a result of refinancing and/or improvements to the property?

If refinancing occurs during the marriage, consideration should be given to its impact in the determination of the community interest in the property. For example:

- The refinancing could be determined to be a community debt without a change to how title is held.
- The refinancing could be determined to be a community debt with a change to how title is held (i.e., a change from separate title to the joint tenancy).
- The refinancing could be determined to be a separate debt.

First, if refinancing occurs during the marriage, a paydown of the original trust deed with community funds may have then occurred. The community is then entitled to a credit for the amount of the refinancing proceeds used to paydown the original trust deed and the related pro tanto interest in the appreciation. It should be noted that under this approach, the community now has the obligation to pay back the new trust deed.

In addition, any payment of this community debt after the date of separation, if not considered to be in lieu of spousal support, and if it exceeds the rental value of the residence, could be considered as reimbursable to the payor. *In re Marriage of Epstein*, 24 Cal.3d 76 (1979). Second, if the title to the property is changed to joint form, it becomes community property as of the date of transmutation pursuant to Civil Code section 4800.1 and then Civil Code section 4800.2 should be applied. The property must be valued as of that date and a Moore/Marsden calculation should be made treating the date of transmutation as a date of separation. This is required in order to determine the separate interest in the property as of that date. *In re Marriage of Kahan*, 174 Cal.App.3d 63 (1985).

It should be noted that the date of the transmutation is critical. If the transmutation occurred before Jan. 1, 1984, unless there is an agreement or understanding to the contrary, it may be considered as a gift to the community. *In re Marriage of Lucas*, 27 Cal.App.3d 366 (1980).

Separate Debt

If, on the other hand, where title is not transmuted into joint form and the refinancing that occurs during marriage is considered to be a separate debt, then, as discussed above, it may be argued that the community is entitled to share in the appreciation only to the extent there has been a reduction of principal in the original loan balance prior to the refinance.

Another possibility would be that the community, after the refinancing occurred, is entitled only to a reimbursement to the extent community funds were used to service the separate debt created during marriage. Although there are no reported cases dealing with this issue, the court may give particular attention to who benefits from the refinance proceeds -- the community, or the spouse in whose name title to the property is held.

Improvements

Until the recent case of *Reiserer v. Foothill Thrift and Loan*, 208 Cal.App.3rd 1082 (1989), no cases have discussed the application of the Moore /Marsden calculation for improvements to a separate residence with community funds. The reported cases before *Reiserer* provided that absent a contrary agreement, improvements were deemed a gift and took on the character of the separate property and belong to its owner. *Camire*, supra.

However, this gift presumption did not apply where the spouse used community funds to improve his or her own separate property without the consent of the other spouse. In these cases the community was reimbursed. *In re Marriage of Jafeman*, 28 Cal.App.3d 777 (1972), and *In re Marriage of Frick*, 181 Cal.App.3d 997 (1986). It is interesting to note that in *Frick*, the majority of the court's opinion dealt with the application of the Moore/Marsden formula to the paydown of a separate mortgage on commercial real property with community funds, and in addressing the improvement issue the court did not discuss the Moore/Marsden line of cases.

No Foreclosure

In *Reiserer*, the court prevented the bank from foreclosing on a residence that was security for a guaranty for a defaulted business loan. To prevent the foreclosure and save the security, the wife persuaded the court that she was likely to obtain a community interest in the property, which she had previously quit-claimed to her husband, by virtue of the community having improved the property with community funds. The *Reiserer* court, in citing *Moore* and *Gowdy* as "improvement" cases, postulated that the wife would be likely to obtain a community interest in the property. However, in doing so, the court would be extending the holding of these cases inasmuch as neither case dealt with the issue of improvements, but only with the reduction of a separate property mortgage with community funds.

If one follows the reasoning in *Reiserer* and therefore applies a Moore /Marsden type approach to improvements, then the property must be valued at the date of separation with and without the improvements in order to determine the enhanced value of the property. In addition, the Moore/Marsden calculation must be made using the value of the property without improvements in order to determine the community interest due to the paydown of the mortgage during marriage.

Without specific code sections or cases controlling the disposition of assets under the foregoing circumstances, our best guide is to follow the Moore/Marsden principals. Some individuals may argue that all of the "wrinkles" discussed above can be integrated into a "modified" Moore/Marsden calculation.

No matter how they suggest that this be done, their basis for suggesting their approach should follow the intent of *Moore* and *Marsden* so as to provide the community with reimbursement anytime it invests in the separate residence.

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