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A Family Farmer and a Deficient Definition: A Search for Analytic Criteria to Classify Hybrid Property in California Purchase Money Anti-deficiency Cases

by

Gregory S. Gordon

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A Family Farmer and a Deficient Definition: A Search for Analytic Criteria to Classify Hybrid Property in California Purchase Money Anti-deficiency Cases

By GREGORY S. GORDON*

"Praise a great estate, but cultivate a small one."[1]
"Farming is not really a business; it is an occupation."[2]

Introduction

MAY A SMALL FAMILY farmer who defaults on a third-party purchase money loan secured by a deed of trust on his farm/residence qualify for anti-deficiency protection under California law? According to section 580b of the California Code of Civil Procedure, the answer to this question depends on whether the entire farm meets the definition of a "dwelling for not more than four families . . . occupied, entirely or in part, by the purchaser."[3] This question boils down to an inquiry as to whether the farm can be deemed "residential," as opposed to "commercial," property, within the meaning of the statute.[4]

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* Clerk to Judge Martin Pence, United States District Court Judge, for the District of Hawaii. B.A., 1985, University of California, Berkeley; J.D., 1990, Boalt Hall School of Law, University of California, Berkeley.

1. VERGIL, GEORGICS Bk. ii, l.412.
2. WILLIAM E. WOODWARD, MONEY FOR TOMORROW 177 (1954).
3. California Civil Procedure Code § 580b provides in pertinent part:
No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than four families given to the vendor to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser.
CAL. CIV. PROC. CODE § 580b (West Supp. 1991).
4. *See* John R. Hetland, *Real Property and Real Property Security: The Well-Being of the Law*, 53 CAL. L. REV. 151, 163 n.51 (1965).

Unfortunately, neither California's legislature nor its courts have attempted to define the meaning of the term "residential" in section 580b. In fact, in more than a century of published case law, no California court has explicitly defined "residential" property in any context.

The distinction between "residential" and "commercial" is critical in many areas of real property law. For example, in landlord/tenant law the distinction may decide whether the implied warranty of habitability is read into a lease or whether strict liability is applied to lessors when an occupant sustains injury on the leased premises.

As a result, the "residential/commercial" lexical void encourages acceptance of the superficial notion, suggested by the skeletal language of the anti-deficiency statute itself, that the term "residential" refers to owner-occupied property for four families or fewer, and that "commercial" property encompasses all other types of real property.[5] This definitional void also presents two problems. First, both courts and commentators suggest with increasing frequency that the "residential/commercial" dichotomy has become the policy lodestar in determining whether a deficiency judgment may lie after the foreclosure sale of real property that secures *both* kinds[6] of purchase money loans.[7] It is problematic for the judiciary to rely on the skeletal definition of the term "residential" when the definition itself may be the driving force behind its decisions to apply section 580b protection. Second, in the specific case of defaults on *third-party* purchase money loans, section 580b explicitly mandates that courts distinguish between "residential" and "commercial" real property. However, the superficial definition of "residential" baffles courts faced with determining a property's status.

These two problems exist in particular when courts apply section 580b anti-deficiency protection to hybrid property. Hybrid property is property possessing both residential and commercial characteristics. The family farm is a good example of hybrid property. Arguably, the farm is "residential," consisting of an "owner occupied dwelling for four families or fewer" as prescribed by the statute. On the other hand, the farm's

5. David A. Leipziger, *Deficiency Judgments in California: The Supreme Court Tries Again*, 22 UCLA L. REV. 753, 754 (1975).

6. Section 580b recognizes two kinds of purchase money lending. The first type entails a vendor taking a note secured by the purchased property. This can be described as a "seller carry-back" purchase money loan. The second type entails a third-party lender taking a note secured by the purchased property if the property consists of a one to four unit, owner-occupied dwelling. This can be referred to as a third-party residential purchase money loan.

7. *See, e.g.*, Cynthia G. Mertens, *California's Foreclosure Statutes: Some Proposals For Reform*, 26 SANTA CLARA L. REV. 533 (1986). The somewhat controversial argument that the residential/commercial nature of real property motivates a court to apply anti-deficiency protection in seller carry-back transactions will be examined in Section I.B, *infra*.

adjoining land is "commercial," since it is used for the incidental production of income. Thus, based on the words of the statute alone, it is difficult for a court to classify the family farm as either "residential" or "commercial" property.[8]

This Article proposes a principled distinction between the "residential" and "commercial" character of hybrid property for the purposes of applying section 580b. Part I demonstrates the necessity for identifying specific criteria to analyze whether property is "residential" or "commercial" under the purchase money prohibition statute. Part II examines section 580b jurisprudence, as well as the jurisprudence of other state and federal law, for guidance in using these criteria. Finally, this Article concludes by applying these criteria to determine the "residential" or "commercial" status of a small family farm.

I. The Evolution of Section 580b

A. Overview of Deficiency Judgments

A definition of deficiency judgment is required to determine the status of property under the anti-deficiency protections. In the deed of trust context, a deficiency judgment is a judgment sought by the beneficiary against the trustor for the difference between the unpaid balance of the secured debt plus expenses and the amount recovered at the foreclosure sale.[9] For example, if at the time of foreclosure $50,000 is owed to the beneficiary and the high bid at the foreclosure sale is $35,000, there is a $15,000 deficiency. The beneficiary may seek a personal judgment against the trustor for this amount if a deficiency judgment is permitted.

Obtaining a deficiency judgment in California, however, is no simple matter. California law presents a series of obstacles, known collectively as the anti-deficiency rules, to a mortgagee or beneficiary seeking a deficiency judgment. There are three major pieces of anti-deficiency legislation in California: the private sale bar, which prohibits any deficiency judgment when the mortgagee or beneficiary has elected to foreclose by power of sale rather than judicially;[10] the fair-value limitations, which limit the size of the deficiency judgment to either (1) the difference between the unpaid debt and the fair value of the security or (2) the differ-

8. The same could be true for many other kinds of properties. For instance, a building could be described as hybrid if it were used as a family residence while at the same time one or more of its rooms were used as an office. Similarly, a corner grocery store would be hybrid if its owner lived behind the store front.

9. *See* ROGER BERNHARDT, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE § 4.13 (Scott ed., 1990).

10. CAL. CIV. PROC. CODE § 580d (West Supp. 1991).

ence between the debt and the sale price of the security, whichever is smaller;[11] and the purchase money prohibition, which forbids deficiency judgments after the foreclosure sale of real property that secures a purchase money loan.[12] This Article focuses its discussion on the purchase money prohibition under section 580b as applied to hybrid property.

B. The Legislative Purpose of Section 580b

The legislature's purpose of section 580b has been elucidated through judicial interpretation, legislative reaction, and academic commentary. Section 580b was enacted during the Great Depression in 1933. Few or no records chronicle the legislative proceedings surrounding its enactment.[13] However, an abundance of judicial explanation of its purposes exists.

Brown v. Jensen[14] first ascribed legislative purpose to section 580b. In *Brown*, the California Supreme Court stated that the legislature intended this section to ensure that a beneficiary looks only to the security to recover a purchase money debt.[15] The court reasoned that a seller who takes a deed of trust knows the value of the security, and therefore, assumes the risk that the security will become inadequate.[16]

Ten years later, however, the court in *Roseleaf Corporation v. Chierighino*[17] effectively rejected this rationale. The *Roseleaf* court doubted that the legislature intended to base 580b protection on the relative astuteness of the buyer and seller.[18] Moreover, the court found the statement in *Brown*, that a beneficiary must look only to the security, stated a conclusion without an explanation.[19] The court instead placed the risk of inadequate security on the vendor:

> A vendor is thus discouraged from overvaluing the security. Precarious land promotion schemes are discouraged, for the security value of the land gives purchasers a clue as to its true market value. If inadequacy of the security results, not from overvaluing, but from a decline in property values during a general or local depression, section 580b prevents the aggravation of the downturn that would result if default-

11. CAL. CIV. PROC. CODE §§ 580a, 726 (West Supp. 1991).
12. CAL. CIV. PROC. CODE § 580b (West Supp. 1991).
13. BERNHARDT, *supra* note 9, § 4.26.
14. 259 P.2d 425 (Cal. 1953).
15. *Id.* at 427.
16. *Id.*
17. 378 P.2d 97 (Cal. 1963).
18. *Id.* at 101.
19. *Id.*

> ing purchasers were burdened with large personal liability. Section 580b thus serves as a stabilizing factor in land sales.[20]

Thus, the court also discerned two distinct objectives of section 580b: (1) to prevent overvaluation, and (2) to stabilize property values during a depression.

However, the *Roseleaf* rationales are questionable. At the same time that *Roseleaf* was decided, the court handed down another significant section 580b ruling, *Bargioni v. Hill*.[21] *Bargioni* held that like purchase money loans acquired from vendors, purchase money loans obtained from third-party lenders were also subject to the anti-deficiency prohibitions of section 580b.[22] The California legislature reacted to *Bargioni* by amending section 580b. The amendment extended anti-deficiency protection to borrowers who obtained purchase money loans from third-parties when the loans were secured by "residential" property.[23] However, the amendment also allowed a third-party lender to recover a deficiency judgment if the loan was obtained to finance the purchase of "commercial" property.[24]

The 1963 amendment to section 580b was extremely significant for two reasons. Initially, it introduced the "residential/commercial" distinction as a factor in deciding whether anti-deficiency protection should be granted. Additionally, as an implicit corollary to the "residential/commercial" dichotomy, the amendment suggested an alternative rationale behind section 580b which questioned the *Roseleaf* rationales. This subtle suggestion caught the attention of many scholars and jurists, who have used it as their rallying cry in assailing the embattled *Roseleaf* rationales. As Professor Leipziger laments:

> In thus introducing a residential/commercial dichotomy into the statute, the legislature laid the groundwork for a theory of its application that is analytically sounder and more predictive than the *Roseleaf* explication. Unfortunately, the courts have continued to apply the *Roseleaf* purposes analysis to factual patterns varying from that in *Roseleaf* often with awkward and unconvincing results.[25]

The problems with the *Roseleaf* rationales are manifold. With respect to preventing overvaluation, section 580b does little, if anything, to discourage this problem. From the seller's point of view, section 580b might *encourage* the overvaluation of the property. If the note is paid, the seller is better off; if the note is not paid, its large size permits a

20. *Id.*
21. 378 P.2d 593 (Cal. 1963).
22. *Id.* at 594.
23. CAL. CIV. PROC. CODE § 580b (West Supp. 1991).
24. *Bargioni*, 378 P.2d at 594.
25. Leipziger, *supra* note 5, at 754-55.

greater credit-bid at the foreclosure sale.[26] From the buyer's perspective, section 580b prevents few judgments that the fair value provisions of sections 580a or 726 would not also prohibit. Only in the rare cases, such as the seller's lending the buyer more money than the purchased property is worth or the property's fair market value decreases below the amount of debt, would section 580b make a difference.[27]

Concerning economic stabilization, commentators point to numerous holes in the *Roseleaf* analysis. If the statute's aim is to impede the advent or aggravation of a depression, its means are far too limited: depressions can be more effectively avoided by giving all debtors, not just purchase money trustors, anti-deficiency protection.[28] Moreover, barring deficiency judgments in cases when the property is truly not worth the debt does not eliminate a loss, but merely shifts it from trustor to beneficiary. The beneficiary may then become the one likely to default on debts, and thus potentially aggravate an economic downturn.[29] Finally, the 1963 amendment to section 580b, which exempts third party purchase money lenders from the deficiency judgment prohibition when the property is "commercial" in nature, tends to discredit the notion that the purpose of the statute is to make creditors a buffer against depressions.[30]

Although the *Roseleaf* court's interpretation of section 580b's legislative purpose does not withstand analytic scrutiny, all published appellate decisions concerning section 580b continue to reference the *Roseleaf* rationale in articulating their *ratio decendi*. Courts still apply the *Roseleaf* rationales[31] even though the real issue in each case is whether the property is "residential" or "commercial,"[32] not whether the objectives of overvaluation prevention and economic stabilization have been satisfied. Professor Mertens comments:

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26. BERNHARDT, *supra* note 9, § 4.28.

27. *See* John R. Hetland, *Deficiency Judgment Limitations In California—A New Judicial Approach*, 51 CAL. L. REV. 1, 5 (1963).

28. BERNHARDT, *supra* note 9, § 4.28.

29. *Id.*

30. *Id.*

31. Professor Mertens suggests that in each of the cases, discussed *infra* note 33, the court seems to apply the *Roseleaf* rationales to justify a result that had already been reached on the basis of the residential/commercial distinction. *See* Mertens, *supra* note 7, at 554.

32. The pattern that has emerged in the published decisions has been to refuse § 580b protection to purchasers of commercial property and to grant it to purchasers of residential property. *See, e.g.*, Roseleaf Corp. v. Chierighino, 378 P.2d 97 (Cal. 1963) (allowing a deficiency judgment where purchased property consisted of non owner-occupied hotel); Spangler v. Memel, 498 P.2d 1055 (Cal. 1972) (allowing a deficiency judgment when property bought was an office building); Brown v. Jensen, 259 P.2d 425 (Cal. 1953) (disallowing a deficiency judgment when property acquired consisted of a residence with no incidental commercial ac-

> The California courts have struggled to apply *Roseleaf's* analysis to achieve protection for the residential purchaser . . . . The effort to protect the residential owners has led to rationales based on the *Roseleaf* purposes which do not withstand close scrutiny. Those purposes should be abandoned, and the real purpose, protection of the residential purchaser, should be articulated and promoted.[33]

While Professor Mertens' description of section 580b jurisprudence is accurate, it is not complete. Even if courts begin to recognize that the "residential/commercial" nature of the purchased property is the controlling factor in these cases, they cannot adequately analyze the nature of the property without specific criteria to distinguish between "residential" and "commercial" property in hybrid cases. This Article formulates such criteria.

II. Criteria for Classifying Hybrid Property

A. Section 580b Cases

Of all the published cases decided pursuant to section 580b, or that cite section 580b, not one defines "residence" in the statute. Some cases have come tantalizingly close to defining "residential," while others drop hints as to what the analytic criteria should be for enriching the current anemic definition.

1. Cases Nearly Defining "Residence"

Cases involving section 580b challenged the courts to define "residence" beyond the literal language of the statute. In each case, the court turned down the challenge. These cases illustrate the California judiciary's reluctance to confront the "residential/commercial" dichotomy. They also provide indirect clues as to the potential scope of "residential" property under section 580b.

For example, the court in *First Federal Savings & Loan Association v. Lehman*[34] teetered on the brink of defining "residence," but ultimately decided that it need not reach the section 580b issue.[35] Instead, the court

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tivity); Prunty v. Bank of America, 112 Cal. Rptr. 370 (1974) (disallowing a deficiency judgment involving owner-occupied home).

These cases will be discussed in greater detail when the definition of "residence" is explored in the next section. In the meantime, it should be noted that each case involves a piece of property which is either clearly commercial or clearly residential. Thus, the court is spared the task of categorizing hybrid property as either "residential" or "commercial" within the meaning of § 580b.

33. Mertens, *supra* note 7, at 554.

34. 205 Cal. Rptr. 600 (1984).

35. *Id.* at 602.

disposed of the case based on section 580d.[36] The court barred a deficiency judgement since the trust deed beneficiary had elected to foreclose by exercising its power of sale.[37]

Other cases provide indirect clues as to the scope of the term "residence." The court in *Allstate Savings & Loan Association v. Murphy*,[38] for example, engaged in an equivocal analysis of whether a swimming pool is part of a "residence" within the meaning of the purchase money anti-deficiency statute. In *Allstate* a lender sought a judgment against a borrower for the unpaid amount on two promissory notes which were secured by trust deeds against the borrower's property and whose proceeds were used for the construction of a swimming pool. The court held that section 580b did not prohibit the lender from seeking a deficiency judgment.[39] In so ruling, the court opined that section 580b contemplates protecting a borrower who takes out a loan to finance the purchase of a dwelling.[40] The court found that a loan obtained for the construction of a swimming pool was not included within the ambit of its protection.[41]

Regrettably, the court's holding is not a model of clarity. On one hand, *Allstate* may be construed as narrowing the definition of the term "residence" to exclude the swimming pool. In concluding that a loan for constructing a pool was not covered by section 580b, the court notes that "construction loans do not fall under section 580b's anti-deficiency provision unless used by the borrower to finance his personal *residence*."[42] This implies that swimming pools are not included within the definition of a "personal residence." On the other hand, the decision may be interpreted temporally, rather than spatially. The court points out that the pool had been built by the borrower seventeen months after the borrower had initially purchased the dwelling.[43] In this sense, the pool is considered an "improvement" to, rather than an integral part of, the dwelling itself. Perhaps if the pool had been constructed at the same time as the

36. California Civil Procedure Code § 580d provides in pertinent part:
No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust.
CAL. CIV. PROC. CODE § 580d (West Supp. 1991).
37. 205 Cal. Rptr. at 602.
38. 159 Cal. Rptr. 663 (1979).
39. *Id.* at 664.
40. *Id.* at 664-65.
41. *Id.* at 664.
42. *Id.* (emphasis added).
43. *Id.* at 664-65.

rest of the dwelling, the court would have considered it a part of the "residence." The court's own language seems to support this interpretation. "We hold that construction loans for improvements or repairs of the type involved in this case are not within the description of loans protected by the purchase money deficiency prohibition of section 580b."[44] Thus, it is possible to interpret the *Allstate* case as either narrowing the scope of "residence" within the meaning of section 580b, or not affecting it at all. Regardless of its interpretation, the case represents weak authority for either proposition.

At least one other section 580b case drops some insubstantial hints as to the scope of "residence." In *Boyle v. Sweeny*,[45] the Court of Appeal for the First District reviewed a ruling that denied anti-deficiency protection to defaulting developers of residential real property. The developers borrowed money from the plaintiff to convert a one-unit residence into a three-unit condominium complex, pledged as collateral to secure the loan. In refusing to grant section 580b protection, the trial court concluded that the condominium project, while intended for residential use, was actually "commercial" property.[46] On appeal, the developers contended that the property's use had not changed from "residential" to "commercial." Consequently, they argued that the *Spangler v. Memel*[47] case was inapplicable and that a deficiency prohibition was mandated.[48]

The court in *Spangler* permitted a vendor, who had agreed to subordinate the deed of trust securing his purchase money loan to a construction lender, to seek a deficiency judgment against a *commercial* developer after the construction lender foreclosed and exhausted the security.[49] In *Spangler*, the "residential/commercial" dichotomy was important since the commercial developer who bought the property intended to change the property from residential to commercial use. For this reason, the *Spangler* court determined that the *Roseleaf* overvaluation prevention rationale was inapplicable since the buyer, not the seller, was in a superior position to calculate the property's true value.[50] Therefore, the *Spangler* court refused to extend section 580b protection.

In contrast, the *Boyle* court held that for the purpose of the case before it, the "residential/commercial" distinction was not dispositive:

44. *Id.* at 664.
45. 255 Cal. Rptr. 153 (1989).
46. *Id.* at 154.
47. 498 P.2d 1055 (Cal. 1972).
48. *Boyle*, 255 Cal. Rptr. at 156.
49. *Spangler*, 498 P.2d at 1062.
50. *Id.* (buyer could calculate the property's true value based on his profit calculation from the commercial venture).

> In their appeal, Sweeney and Brown contend that the use of the property has not changed from residential to commercial. In essence, they argue that *Spangler* and its progeny were intended to apply only if the purchasers intend a change in use—such as from residential to commercial—rather than a mere change in the intensity of a single use—such as from a single residence to a three-unit condominium. They challenge the trial court's finding that the three-unit condominium project was a commercial one. They contend that they were residential developers and that this fact entitled them to the protection afforded by section 580b. We disagree. Section 580b distinguishes between commercial and residential uses when the noteholder is a lender, rather than the vendor of the underlying property. However, this distinction is not determinative when, as here, the noteholder is the vendor.[51]

Thus, the court comes painfully close to defining the scope of the terms "residential" and "commercial" property. However, it decides the case on different grounds.

It is difficult to determine the *Boyle* court's interpretation of the "residential/commercial" distinction. Does the court's silence concerning the "residential/commercial" nature of the property affirm the trial court's finding that the condominium complex was commercial property? If it does, how significant is this determination in light of the fact that the owner probably never intended, or never actually occupied the building? Without owner-occupancy, even the literal language of section 580b would deem the condominium complex "non-residential." Far more helpful, for purposes of this analysis, would have been a situation in which the developer lived in one of the condominium units and derived incidental income from the sale of the other two units. Presumably, the *Boyle* case does not present this kind of scenario. Even if it did, the court's refusal to describe the property as either "residential" or "commercial" leaves little conceptual grist for the lexical mill.

2. Cases Furnishing Analytic Criteria

Section 580b cases furnishing analytic criteria focus on the relationship between the debtor and the creditor instead of on the property. There are two categories of these cases. The first category explores the borrower's bargaining power against the lender. The second category analyzes the debtor's and the creditor's capacity to shoulder the burden of risk.

51. *Boyle*, 255 Cal. Rptr. at 156 (citations omitted).

a. The Bargaining Power Criterion

This first criterion concentrates on the debtor's ability to negotiate for anti-deficiency protection when entering into an agreement with a creditor. If the debtor's bargaining power is commensurate to that of the creditor, the property should be deemed "commercial." If the debtor has less bargaining power than the creditor, the property should be defined as "residential" for the purposes of section 580b.

Kistler v. Vasi[52] aptly describes the importance of bargaining power in determining the nature of a transaction for the purposes of section 580b. *Kistler* involved real estate brokers, the plaintiffs, who acted for defendants to purchase an apartment building. Plaintiffs also financed the defendants' acquisition.[53] In lieu of a cash payment for plaintiffs' commission, plaintiffs accepted a note from defendants for $17,500 secured by a second deed of trust on the purchased apartment building.[54] When defendants defaulted on their obligations and the security was exhausted by a sale under the first deed of trust, plaintiffs instituted an action against defendants to recover the balance due on the promissory note.[55] The trial court granted defendant's motion for summary judgment on the ground that section 580b barred any recovery.[56]

However, in an opinion by Chief Justice Traynor, the California Supreme Court reversed the judgment.[57] The court held that the loan at issue constituted a third-party purchase money loan.[58] Under the 1963 amendment of section 580b, a deficiency judgment is only allowed if the purchased property consists of a "dwelling for not more than four families occupied, entirely or in part, by the purchaser." In other words, anti-deficiency protection extends only to "residential" property.[59] The court, in *Kistler*, found that the purchased property was not residential.[60]

Chief Justice Traynor's analysis did not examine the purchased apartment building components in determining whether the property qualified as "residential" property. Instead, he tersely concluded:

> The amendment limits the protection given vendees against nonvendor purchase money lenders to vendees of defined residential property. Since the property in this case is unimproved commercial property,

52. 455 P.2d 106 (Cal. 1969).
53. *Id.* at 107.
54. *Id.*
55. *Id.* at 106.
56. *Id.*
57. *Id.* at 108.
58. *Id.*
59. *Id.* at 107.
60. *Id.*

> section 580b no longer precludes third-party lenders of purchase money for such property from obtaining a deficiency judgment.[61]

However, Traynor next confronted the purchaser's argument that the brokers should be considered vendors and not third-party lenders for purposes of section 580b. The purchasers argued that the vendors, disguised as third-party lenders, managed to evade the protection that section 580b was enacted to provide.[62] Traynor disagreed.[63] In an extremely important passage, the Chief Justice explained that when lenders seek to evade the strictures of section 580b, it is necessary to consider whether the borrower was capable of bargaining for anti-deficiency protection before entering into an agreement with the lender.[64] If the borrower was capable but simply failed to insert such protection into the agreement, the courts would not insert it for the borrower *nunc pro tunc* through the safety net of section 580b.[65] Traynor implied that, in the commercial context, the borrower always possesses the requisite bargaining power:

> [The 1963] amendment [to section 580b] expressly distinguishes between lenders of purchase money and vendors and contemplates that the parties to a sale of real property, *other than the defined residential property*, may freely elect to arrange for the financing of the purchase price in ways that may wholly or in part limit the vendee's protection from deficiency judgments . . . . It is reasonable to assume that had defendants bargained for the protection of section 580b with respect to plaintiff's note and deed of trust, they would have given some *quid pro quo*.[66]

Although Traynor's discussion of bargaining power focuses on the identity of the lender as either vendor or third-party lender, his analysis generally applies to the issue of whether section 580b protection should ever shield the defaulting borrower. Traynor states that if the property is "commercial," the borrower is presumed to have the requisite bargaining power. If the borrower has the requisite bargaining power in a transaction involving hybrid property, the hybrid property is most likely "commercial."[67] Thus, a bargaining power analysis may aid in the determination of whether the purchased property is "residential" or "commercial."

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61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* at 108.
65. *Id.*
66. *Id.* at 107-08 (emphasis added).
67. To complete the residential/commercial determination under current section 580b jurisprudence, the parties' abilities to shoulder the risk of loss in case of default must be considered. This will be explored in greater detail Section II.A.2.b *infra*.

The legislature's purpose in amending section 580b in 1963 was in part to protect the unsavvy buyer who could be driven to personal financial ruin by the unscrupulous third-party lender.[68] Presumably, the unsophisticated residential purchaser best fits the legislature's concept of such a buyer. One of the hallmarks of legal naivety is an absence of bargaining power. Hence, in a residential *cum* commercial hybrid case, the borrower's ability to negotiate for anti-deficiency protection in the agreement may be a deciding factor in classifying the purchased property.[69]

b. The Risk of Loss Criterion

While the bargaining power criterion focuses on the parties's strengths and weaknesses *before* they enter into the transaction, the risk of loss criterion centers on the parties' strengths and weaknesses before *and* after they enter into the transaction. This criterion aims to determine which party, prior to the transaction, is better able to estimate the property's true value and to take precautions against the risk of default. After the transaction is consummated, inquiry focuses on the parties' abilities to absorb the loss after the borrower defaults. In the case of hybrid property, if the lender can anticipate and assume the risk of loss better than the borrower, the property would be designated "residential" under this criterion. If the opposite is true, or there seems to be equality of foresight and hardship, the property would be deemed "commercial."

Spangler v. Memel[70] was the first case in California to allude to the risk of loss criterion.[71] In *Spangler* a commercial real estate developer sought section 580b protection when sued for a deficiency judgment by the vendor, a sold-out junior lienor, after the senior lienor, a construction lender, extinguished the security at a foreclosure sale. The court refused to give the developer protection under section 580b.[72] The court reasoned that under the *Roseleaf* overvaluation prevention rationale,[73] over-

68. *Kistler*, 455 P.2d at 107.

69. At least one other case, Budget Realty, Inc. v. Hunter, 204 Cal. Rptr. 48 (1984), indirectly recognized the bargaining power element in deciding whether purchased property was residential or commercial for section 580b purposes. "If the Legislature determines that commercial transactions should be outside 580b application, the Legislature could amend 580b to apply only to residential transactions. *Explicit negotiations in commercial contexts might be desirable.*" *Id.* at 52.

70. 498 P.2d 1055 (Cal. 1972).

71. *Id.*

72. *Id.* at 1062.

73. *Id.* Conversely, the court found that the purpose of aggravating a depression in land values had little applicability to the situation presented. The court noted:

If section 580b is applied to prevent the deficiency judgment, then the subordinating

valuation was better prevented by permitting the sold-out junior lienor vendor to recover a deficiency judgment since the developer could better evaluate the potential value of the property based on the likelihood of commercial success.[74] In coming to this conclusion, however, the court pondered the equities under the risk of loss rationale:

> If in such situation section 580b is applied to prevent the vendor from suing on his promissory note, after the development has failed and the senior lienor has caused the property to be sold, the risk of failure of the commercial development is thrust upon the vendor. In fact, however, the success of the commercial development depends upon the competence, diligence and good faith of the developing purchaser. It would seem proper, therefore, that the purchaser not the vendor bear the risk of failure, particularly since in the event of default, the junior lienor vendor will lose both the land and the purchase price.[75]

Although the court couched its language in the *Roseleaf* overvaluation prevention analysis, the court created a risk of loss criterion. In *Spangler*, the borrower's sophistication, superior insight into the potential for failure, and knowledge of the property's value together with the lender-vendor's severe financial misfortune, tilted the risk of loss toward the lender. Had that property been hybrid, the risk of loss analysis would have required designating the property as "commercial."

In *Prunty v. Bank of America*,[76] the California judiciary began to develop the risk of loss criterion. *Prunty* involved a borrower who sought declaratory relief to bar any future deficiency judgment after a landslide destroyed the dwelling which secured his loan. The trial court entered a declaratory judgment in favor of the borrower under section 580b, and prohibited the lender from obtaining a deficiency judgment after judicial foreclosure and sale.[77]

On appeal, the lender argued that section 580b did not bar a deficiency judgment because the deed of trust given by the borrower was not a "purchase money" instrument within the meaning of the statute.[78] The lender pointed out that the borrower had initially acquired the unimproved real estate with his own funds.[79] The borrower obtained the con-

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sold-out junior lienor loses both the land and the purchase price. If section 580b is not applied then the purchaser is subjected to the same burden. Neither party has the land in this context; the sole question is who shall bear the cost of the unpaid portion of the purchase price.

Id. The court concluded with the predicate query leading to the "risk of loss" analysis.

74. *Id.* at 1061.
75. *Id.*
76. 112 Cal. Rptr. 370 (1974).
77. *Id.* at 371.
78. *Id.* at 373.
79. *Id.*

struction loan later.[80] Since the loan was not technically used to purchase the property, but rather to improve it, the lender maintained it was not a purchase money loan under section 580b.[81]

The Court of Appeal for the First District rejected the lender's argument.[82] First, the court explained that the California judiciary has always exhibited a very hospitable attitude toward the legislative policy underlying the anti-deficiency legislation and has broadly and liberally construed statutory language.[83] Within such broad parameters, the court had no compunction to categorize this transaction as a purchase money loan.[84]

Furthermore, the court cited independent policy justifications, using a risk of loss analysis, for extending 580b protection. Couching its analysis in *Roseleaf's* overvaluation prevention rationale,[85] the court developed a risk of loss analysis using economic downturn prevention language.[86] In an extremely important passage, the court pointed out that the risk of loss is better borne by the lender, a large bank which knows the potential risks of residential ownership and has a greater ability to shoulder the loss.

> In the present case, it seems particularly appropriate that the "risk," and the ensuing loss in consequence, be borne by defendant bank because of the opportunities it had—and utilized—to protect its security interest against the landslide loss which actually occurred. These opportunities included the control exercised by the bank over the plans, specifications and construction of plaintiff's residence in contemplation of landslide and other physical risks, and the requirement in plaintiffs' trust deed that they furnish insurance whose coverage protected the bank against loss and which was "satisfactory" to it. We may reasonably assume that such protective measures are readily available to lenders who finance residential construction, that the Legislature was aware of this when it amended section 580b in 1963, and that its protection of residential construction borrowers, against deficiency judgments, was continued (under the 1963 amendment) in recognition of the fact that the lenders involved are able to protect themselves against loss or devaluation of their security which might be caused by physical catastrophe. Under these and all the circumstances previously discussed, we hold that section 580b bars a deficiency judgment in the present case.[87]

80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.* at 374.
84. *Id.*
85. *Id.* at 377.
86. *Id.* at 377-78.
87. *Id.* at 378.

Prunty dealt with a piece of property that was clearly "residential" under the literal language of section 580b. However, had that property been hybrid, the court could have applied the risk of loss factors to determine whether the property was "residential" under section 580b. The facts of *Prunty* revealed that the lender was better able to evaluate and take precautions against the risk of destruction (as opposed to default) and that the lender was better able to absorb the pecuniary loss. If the property in *Prunty* had been hybrid, the risk of loss criterion would have compelled designating the property as "residential."

The importance of *Prunty*, which expanded the risk of loss concept originated in *Spangler*, cannot be expressed. The court in *Prunty* willingly liberated the risk of loss analysis from the *Roseleaf* confines. *Roseleaf* never considered the possibility of physical destruction of the security. *Prunty*, however, forced physical destruction and quasi-purchase money instruments into the 580b crucible. As a result, the court could freely focus more exclusively on the distribution of justice between a commercial lender and a residential borrower. In *Prunty*, physical destruction was a metaphor for financial ruin. The court's decision in *Prunty* assured that the risk of loss analysis would further develop.[88]

88. A more recent case which makes oblique reference to the risk of loss analysis was Nickerman v. Ryan, 155 Cal. Rptr. 830 (1979). In *Nickerman*, the court affirmed the trial court's award of a deficiency judgment on a note secured by certain parcels of commercial property. The note was given pursuant to an agreement resulting from a divorce decree. The plaintiff spouse conveyed her interest, as a tenant in common, to her husband in the parcels of land and took back a second deed of trust on the property. When the senior lienor foreclosed on the first deed of trust, plaintiff sued on the underlying note. The defendant husband sought § 580b protection by claiming that the second deed of trust represented a purchase money note.

In finding that section 580b did not shield the husband, the court relied in part on risk of loss analysis and concluded that it would be unfair to place the risk of the business venture on the wife who sold her interest in order to liberate herself from the risks and responsibilities of management of the property. *Id.* at 836. The court declared:

> The parties here as tenants in common wanted to vest in the defendant the management and control of the commercial properties. The plaintiff wanted to be free of that burden. It would be ironic to hold that the plaintiff who entered into the transaction to be free of the vicissitudes of the commercial enterprises, and so surrendered her joint right of control, should find that her fair share of the joint property was lost because of the sole management of the defendant who assumed the risks of the motel and apartment business.

Id. at 836.

Similar to other risk of loss cases, *Nickerman* involved non-hybrid property. However, since the husband was the commercial manager of the properties, he was in a superior position to evaluate and take precautions against the risk of loss inherent in the commercial ventures. If the property at issue had been hybrid, it would have undoubtedly qualified as "commercial" property.

c. The Interaction of the Criteria

Up to this point, the two analytic criteria[89] have been examined individually. Bargaining power is the ability to negotiate anti-deficiency protection into a real estate secured transaction agreement.[90] The risk of loss criterion considers which party is better able to (1) estimate the true value of the security, (2) take precautions against the risk of default, and (3) shoulder the impact of the pecuniary loss.[91] To consider the relationships of these two criteria, their definitions must be remembered.

Thus far, this Article has established, using the analytic criteria, that hybrid property is "residential" when the borrower is: (1) not capable of negotiating anti-deficiency protection into the loan agreement; (2) in an inferior position to estimate the true value of the security; (3) less capable of taking precautions against the risk of default; and (4) less capable of shouldering the impact of pecuniary loss. All other property may be defined as "commercial" for section 580b purposes. The courts must apply the criteria on a case-by-case basis. If one or more of the analytic criteria are not satisfied, the court must weigh the remaining satisfied criteria against the unsatisfied criteria to determine if the property qualifies as "residential" and anti-deficiency protection should be extended.

This analysis would be incomplete without considering other areas of California[92] and Federal law to see whether these factors successfully enable those laws to apply to hybrid property.

B. Other Areas of California Law

In California, commercial and residential property are distinguished in several other areas of law. The laws accord greater protection to residential owners and occupants. These areas are: (1) landlord and tenant law; (2) miscellaneous real estate law; and (3) homestead law.[93]

89. Additional criteria vital to the completion of the analysis will be examined in the discussion of the California homestead laws in Section II.B.3., *infra*.

90. *See supra* notes 72 to 89 and accompanying text.

91. *See supra* notes 72 to 89 and accompanying text.

92. It should be noted that while a few other states, viz., Montana, North Carolina, Oregon and South Dakota, bar purchase money deficiency judgments, only California extends the protection to third-party purchase money loans. Consequently, California is the only state in the Union that has journeyed down the residential/commercial dichotomy path with respect to purchase money loan anti-deficiency protection. *See* GEORGE E. OSBORNE, REAL ESTATE FINANCE LAW 710 n.89 (2d ed. 1979).

93. In addition, homestead law provides us with additional criteria necessary to complete the analysis in Section II.B.3, *infra*.

1. Landlord and Tenant Law

In the landlord and tenant setting, a residential/commercial distinction appears in implied warranty of habitability case law. In California, every landlord of a dwelling unit impliedly warrants that the premises are fit for habitation at the time of letting and will remain so during the term of the tenancy.[94] This implied covenant is known as the implied warranty of habitability.[95]

The implied warranty of habitability uniquely applies to residential leases under *Schulman v. Vera*.[96] In limiting the warranty of habitability to residential leases, the *Schulman* court's reasoning closely mirrored the reasoning used to define "residential property" in purchase money anti-deficiency cases. The *Schulman* court stressed, using a risk of loss analysis, that in the residential landlord and tenant setting, the landlord is better acquainted with the potential problems of the dwelling before the lease is entered into, and is better able to absorb the financial cost of repairs once the tenant inhabits the dwelling.[97] Regarding bargaining power, the court stated that the landlord is usually more sophisticated, and thus, is in a superior position.[98] The court observed:

> [T]he primary rationale for the decision in *Green* [which first recognized an implied warranty of habitability in all leases] was the change in the relationship between landlord and tenant in respect to urban, residential leases, and the court repeatedly restricted its statements and its holding to residential leases. The court stressed the complexity of modern apartment buildings having *complicated heating, electrical and plumbing systems hidden from view*, the limited tenure of today's urban tenant which frequently will not justify extensive repair efforts, *the unavailability to the average urban apartment dweller of financing for major repairs*, and the *unequal bargaining power* of landlord and tenant resulting from the scarcity of adequate housing in urban areas.[99]

The considerations in warranty of habitability law which characterize the lease as residential—the landlord's more intimate acquaintance with the dwelling's problems, the landlord's greater ability to absorb the financial loss of needed repairs (risk of loss), and the landlord's superior negotiating position (bargaining power)—similarly characterize the property in the purchase money loan anti-deficiency context as "residential."[100] If the dwelling in the warranty of habitability context were hy-

94. *See* Green v. Superior Court, 517 P.2d 1168 (Cal. 1974).
95. *See id.*
96. 166 Cal. Rptr. 620 (1980).
97. *Id.* at 625.
98. *Id.*
99. *Id.* at 624-25 (emphasis added).
100. The residential/commercial distinction is also used in tort cases when courts consider

brid, a court could undoubtedly weigh the risk of loss and bargaining power criteria in order to determine whether the property is "residential" or "commercial."

2. Miscellaneous Real Estate Law

Several statutes accord special protection to residential, as compared to commercial owners of real property. Unfortunately, few, if any, of these statutes have a legislative history or have had judicial interpretions of the term "residential" in hybrid property cases.[101]

a. Impound Accounts

Civil Code section 2954[102] provides that impound accounts[103] can only be required in certain situations. An impound account is an account containing money for the payment of expenses such as taxes, insurance, and homeowner's assessments. The debtor pays a percentage of the amount due monthly along with the mortgage payment. One situation

whether to apply strict liability to lessors in response to an occupant's sustaining injury on the leased premises. In Becker v. IRM Corp., 698 P.2d 116 (Cal. 1985), the California Supreme Court held: "A landlord engaged in the business of leasing dwellings is strictly liable in tort for injuries resulting from a latent defect in the premises when the defect existed at the time the premises were let to the tenant." *Id.* at 122.

However, as the *Becker* court indicated, its extension of strict liability to injuries suffered by a tenant resulting from a latent defective condition of the premises was based on the rationale that *residential* leases contain an implied warranty of habitability. *Id.* at 120. Thus, similar to the inapplicability of the implied warranty of habitability to commercial leases, strict liability is not imposed on lessors whose tenants are injured in commercial premises. As the court in Muro v. Superior Court, 229 Cal. Rptr. 383 (1986), reasoned:

> The analysis in *Green* and *Becker* of the realities of the modern residential market with its need for enforcing an implied warranty of habitability does not necessarily apply to the commercial-industrial rental market. Housing has unique policy implications. Although public policy embodied in the widespread enactment of comprehensive housing codes compels landlords to bear primary responsibility for maintaining safe, clean and habitable housing, we know of no equivalent policy with respect to commercial buildings. Furthermore, a commercial tenant cannot raise an implied warranty of habitability defense in an unlawful detainer proceeding. Moreover, while residential tenants additionally need protection because of the legislatively recognized severe housing shortage in the state there is no scarcity of commercial property. Also, unlike residential tenants, but like landlords, commercial tenants can absorb the costs as a business expense.

Id. at 388-89 (citations omitted).

101. With the exception of CAL. CIV. CODE § 2079 (West Supp. 1991), which has been interpreted by case law to uniquely interpret the scope of the term "residential" in hybrid property situations, the definition of "residential" for hybrid property will be examined in detail in Section II.B.2(e), *infra*.

102. CAL. CIV. CODE § 2954 (West Supp. 1991).

103. Impound accounts are regulated by CAL. CIV. CODE §§ 2954, 2954.1, 2954.8 (West Supp. 1991).

where an impound account can be required is when the amount of the loan is ninety percent of the sale price.[104] The statute extends protection, however, only if the loan is procured for a "single-family, owner-occupied dwelling."[105] Further, the borrower must occupy the dwelling within ninety days of the loan.[106]

Civil Code section 2954.8[107] affords additional protection by requiring creditors to pay interest on money held in impound accounts if the account has been established for purposes related to residential property.[108] Section 2954.8 defines residential property as a "one-to-four family residence."[109]

b. Pre-Payment Charges

Civil Code section 2954.9[110] declares that the principal and interest on any loan secured by a mortgage or deed of trust on a piece of residential property of four units or less may be prepaid without penalty after five years from the date of execution, or may be prepaid with certain specified penalties within the first five years.[111]

c. Late Charges

Civil Code section 2954.4[112] limits the late payment charges for installments on mortgages or deeds of trust secured by a single-family, owner-occupied dwelling to either: (1) six percent of the installment due, or (2) five dollars, whichever is greater.[113]

104. CAL. CIV. CODE § 2954(a)(4)(i).

105. CAL. CIV. CODE § 2954(a).

106. *Id.* § 2954(c).

107. CAL. CIV. CODE § 2954.8.

108. *Id.* § 2954.8(a).

109. *Id.*

110. CAL. CIV. CODE § 2954.9 (West Supp. 1991).

111. *Id.* Professor Mertens notes that there are numerous reasons why borrowers may wish to prepay their loans:

> The principal reason is that the home which is security for the loan is sold. Generally the note is paid in full when the new purchasers obtain their loan, thus triggering a potential prepayment penalty. The original borrower may wish to refinance the loan due to a decrease in interest rates. A borrower may desire to refinance in order to pay off the first loan, yet capitalize on the equity, thus permitting the borrower to put extra cash in the bank.

Mertens, *supra* note 7, at 558 n.120.

112. CAL. CIV. CODE § 2954.4 (West Supp. 1991).

113. *Id.* § 2954.4(a).

d. Liquidated Damages

Civil Code section 1675[114] governs liquidated damage clauses in purchase and sale contracts for residential property. If the amount specified as liquidated damages is limited to three percent of the purchase price, the clause is presumed valid.[115] If that amount is greater than three percent of the purchase price, the clause is presumed invalid.[116] The section specifically defines "residential real property" as property that contains not more than four residential units and property that "at the time the contract to purchase and sell is made, the buyer intends to occupy as his residence."[117]

e. Duty of Broker to Inspect Residential Real Property

Civil Code section 2079[118] governs the duty of brokers to inspect residential real property. Section 2079 obligates brokers selling property of "one-to-four dwelling units" to conduct an inspection of that property and disclose any facts affecting the value or desirability of the property to prospective buyers.[119]

Smith v. Rickard[120] interpreted the scope of the term "residential" within the meaning of section 2079. In *Smith*, a purchaser of real property containing a residence and a commercial orchard brought an action against the sellers' agents, who were also brokers, alleging that the agents failed to inspect the property and disclose that a number of the orchard trees were diseased. Following trial, the jury found that the brokers were negligent on this basis.[121] The Court of Appeal reversed,[122] holding that the "presence of a residence on the commercial property does not transform the property into residential property."[123]

Although *Smith* implied that hybrid property can be uniformly defined as "commercial" property, only a superficial reading of that case would obviate the necessity for writing this Article. *Smith* did not rely on bargaining power or risk of loss criteria, which examine the strengths and weaknesses of the buyer/borrower/tenant and the seller/lender/landlord. Closely examining *Smith* reveals that the court based its ra-

114. CAL. CIV. CODE § 1675 (West Supp. 1991).
115. *Id.* § 1675(c).
116. *Id.* § 1675(d).
117. *Id.* § 1675(a)(1)-(2).
118. Cal. Civ. Code § 2079 (West Supp. 1991).
119. *Id.*
120. 254 Cal. Rptr. 633 (1988).
121. *Id.* at 635.
122. *Id.* at 639.
123. *Id.* at 638.

tionale on the broker's duty to inspect. In essence, *Smith* held that a broker has no duty to inspect the commercial portion of hybrid property. This is a logical conclusion since a residential real estate broker is not qualified to inspect commercial facilities.[124]

Moreover, the *Smith* court implied that, even if it were to base its decision on the bargaining power and risk of loss rationales, these criterion tilt the scales in favor of labelling the property "commercial."[125] Since the court in *Smith* ruled in favor of the brokers, it is likely that it simply found that the plaintiff was both in a favorable commercial or legal position, and possessed the requisite bargaining power sufficient to make the property "commercial." In fact, the court suggested that it engaged in such a balancing process and came out on the side of classifying the property as commercial.[126]

> One might argue that Smith is protected by these statutes because his property is "improved" with one, and not more, dwelling units. These statutes do not expressly or impliedly require that the property be of limited acreage, nor do they require that the property be used only for residential purposes. In a similar vein, Smith argues that because his residence is on the property, he comes within the protection of section 2079. Under this reasoning, if the prospective purchaser of a large factory intends to live in a home on the same land as the factory, the entire real property on which both the factory and the house are located would be covered by the statute . . . .[127] Such an argument

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124. The *Smith* court stated:

> [It] is not difficult to draw the line between the residential and commercial portions of the property. . . . Even though Smith may have been motivated to purchase the property because of the residence, the defect in the property concerned not the residence, but only the commercial portion of the property. This precludes the application of section 2079.

Id.

125. The brokers themselves argued on appeal that the plethora of new legislation, including § 580b, giving extra protection to residential owners of real property, was intended to help those who are less sophisticated and in an inferior commercial or legal position.

> Realtors point out that section 2079 et. seq. is one of those statutory schemes where the Legislature distinguishes between residential and commercial properties in order to protect unsophisticated buyers and owners of residential property from those with greater knowledge and bargaining power.

Id. at 637 (emphasis added) (citations omitted).

126. The court's balancing process seems to have included an inquiry into: (1) the *intent* of the plaintiff in purchasing the property: "he purchased it with the intent to continue to grow and sell avocados"; and (2) the *principal use* to which the plaintiff devoted the property: "his reason for purchasing the land was to use the profits from the sale of the avocados to make his payments for the ranch does not alter the nature of the property." *Id.* at 638. These two elements, which are essential in evaluating whether hybrid property is residential or commercial, will be analyzed in greater detail in the discussion of homestead law in Section II.B.3., *infra*.

127. In *Smith*, the plaintiff had 25 acres of income producing fruit trees. 254 Cal. Rptr. at 638.

> would be more persuasive in the case where a buyer intends to use a room in the residence as an office for business or profit-making activities.[128]

The court in *Smith* allowed a residence on which incidental income-producing activity occurred to be defined as "residential." Therefore, just because commercial activity takes place on property considered to be a residence does not mean that the property will be defined as "commercial." On the other hand, simply because a primarily commercial piece of property has a residence on it, the property is not necessarily deemed "residential." As a result, a court must engage in a balancing process which weighs, inter alia, the bargaining power and the risk of loss criteria to define the property accurately. Apparently, the *Smith* court preferred this balancing process and concluded that the property was commercial under section 2079.

f. Summary of Residential Owner and Resident Protections

Except for section 2079, none of these statutes have had judicial elaborations on the specific nature of residential property in hybrid cases. However, they show the legislature's concern about protecting the residential property owner. In this respect, these statutes offer further proof, albeit indirectly, that the legislative motivation behind the "commercial/residential" distinction in section 580b is quite strong and rooted in a desire to protect "the little guy." In cases of hybrid property, the persuasiveness of the bargaining power and the risk of loss rationales, which focus on the financial and legal inferiority of the residential owner, is bolstered by the omnipresence of "residential-preferential" legislation in California.

C. Homestead Law: Two Additional Criteria

Homestead law does not rely on the positions of borrower and lender. Instead, the homestead exemption in California provides two additional criteria indispensable to completing this analysis. While not rooted in the "risk of loss" and the "bargaining power" rationales, homestead law presents an excellent example of hybrid property that may be categorized as "residential."

Black's Law Dictionary defines a "homestead" as "the dwelling house and the adjoining land where the head of the family dwells; the home farm. The fixed residence of the head of a family, with the land and buildings surrounding the main house."[129] Black's defines the

128. *Id.*
129. BLACK'S LAW DICTIONARY 661 (5th ed. 1979).

"homestead exemption" as "allowing a householder or head of family to designate a house and land as his homestead, and exempting the same homestead from execution for his general debts."[130]

The policy behind the homestead legislation is to secure for every family certain and uninterrupted enjoyment of a home. It seeks to provide a place where the family may reside and enjoy the comforts of a home, free from any anxiety that it may be taken from them, either by reason of their own necessity or by the importunity or rapacity of their creditors.[131]

While the rationales behind the homestead exemption and the purchase money anti-deficiency statute have certain differences, they have similar overreaching purposes. They both seek to protect the financial personal and inner sanctum of a defaulting debtor from his or her creditors. The homestead exemption seeks to protect the residence from creditors and the purchase money anti-deficiency statute attempts to protect the owners of a residence from creditors (with respect to third-party loans). Therefore, the scope of a residence for purposes of the homestead exemption can serve as a valuable yardstick for measuring the scope of a "residence" under section 580b.

The cases interpreting the nature and scope of a homestead in California uniformly agree that the homestead may include areas, integral to the dwelling itself or adjoining thereto, used for the incidental production of income.[132] Such areas may include a garden or a farm.[133] As the Supreme Court of California instructed in *Gregg v. Bostwick*:[134]

> [The homestead] represents the dwelling house, at which the family resides, with the usual and customary appurtenances, including outbuildings of every kind necessary or convenient for family use and lands used for the purposes thereof. If situated in the country it may include a garden or farm . . . . Whatever is used—being either necessary or convenient—as a place of residence for the family as contradistinguished from a place of business, constitutes the homestead, subject to the statutory limit as to value.[135] If, however, it is also used as a place of business by the family, which frequently happens, it may not

130. *Id.*

131. Keyes v. Cyrus, 34 P. 722 (1893).

132. *See, e.g.*, Gregg v. Bostwick, 33 Cal. 220 (1867).

133. *Id.*

134. *Id.*

135. The amount permitted for the homestead exemption is the actual cash value of the property, over and above all liens and encumbrances on the property at the time of any levy of execution thereon. *See* CAL. CIV. CODE § 1260, *repealed by* CAL. CIV. PROC. CODE § 704.730 (West Supp. 1991).

> therefore cease to be a homestead, if it would be necessary or convenient for family use independent of the business.[136]

The physical extent of the homestead is measured by the owner's intent and principal use of the property, and not by imaginary or artificial lines. Fences alone cannot limit such extent, nor can they enlarge it.[137] Indeed, hundreds of acres of land, fenced and cross-fenced, have been held to be a single homestead.[138]

However, there are limits to the scope of the homestead. In *Ackley & Dana v. Chamberlain*,[139] a judgment creditor sought to levy execution on a hotel and an adjoining farm occupied by the debtor and his family. The debtor claimed that the hotel and the farm constituted a homestead and were exempt from execution.[140] The California Supreme Court agreed,[141] emphasizing that the debtor intended to use the hotel and the farm as a residence.[142] Moreover, the premises were principally used as a residence.[143] Thus, two elements must be present to qualify as a residence under the homestead law: (1) "intent" and (2) "principal use."

The *Chamberlain* court aptly illustrated the existence of these two elements in its ruling. With respect to "intent," the court observed:

> In this case the building was intended for a dwelling-house, as well as a hotel. It was the intention of the owner in its construction to make it his residence. It was occupied by him and his family as such residence before it was ever used as a hotel. The nature and extent of the business did not interfere with its general character as a dwelling house. The keeping of boarders and accommodation of lodgers and travelers were not inconsistent with the main purpose of taking up the one hundred and sixty acres [the size of the farm], and the erection of the building.[144]

Regarding the "principal use" requirement, the court noted:

> A homestead is the residence of the family—is the place where the home is—and it would seem unreasonable, upon first impressions, that premises should be regarded as a homestead, unless devoted principally to such residence and home. It would seem unreasonable, for example, that a gas factory should be impressed with the character of a homestead, because the owner resided with his family in the upper story of the building,[145] or that a store-house should become exempt

136. 33 Cal. at 227-28.
137. *Id.*
138. *See* Payne v. Cummings, 80 P. 620 (1905).
139. 16 Cal. 181 (1860).
140. *Id.* at 183.
141. *Id.* at 184.
142. *Id.* at 183.
143. *Id.*
144. *Id.*
145. This is strikingly similar to the example given 128 years later in Smith v. Rickard,

from execution, because the owner occupied the basement in the same way.[146]

Given the similarity in residential debtor-protection objectives between the homestead exemption and the purchase money anti-deficiency statute, it is perfectly logical to apply the criteria for defining the boundaries of a residence of the former to the latter. Thus, we can expand our set of analytic criteria necessary to identify "residential" property in section 580b hybrid situations to include the homestead criteria of purchaser's intent and principal use.

D. Interaction of All Four Criteria

The first two criteria, bargaining power and risk of loss, concentrate on the relationship between the borrower and the lender. Our final two criteria, intent and principal use, focus on the relationship between the borrower and the property. Therefore, hybrid property qualifies as "residential" property under section 580b, if the borrower: (1) has inferior bargaining power; (2) is less capable of evaluating and shouldering the risk of default; (3) intends to use the property primarily for residential purposes; and (4) devotes the principal use of the property to residential purposes.

E. Federal Law

Federal law supports this analytical framework and recognizes that hybrid property may be classified as residential. In particular, both the Home Owners Loan Act of 1933 ("HOLA")[147] and the Housing Act of 1949 ("Housing Act")[148] provide financial and other assistance to residential homeowners irregardless that incidental income-producing activity takes place on the property.

1. The Home Owners Loan Act

HOLA created, inter alia, the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation. It also established many benefits and protections for residential borrowers in the United

254 Cal. Rptr. 633 (1988), to explain how predominantly commercial premises with dwelling quarters on them should not qualify as residential within the meaning of Civil Code § 2079. *Id.* "Under this reasoning, if the prospective purchaser of a large factory intends to live in a home on the same land as the factory, the entire real property on which both the factory and the house are located would be covered by the statute." *Id.* at 637-38.

146. 16 Cal. at 183.

147. 12 U.S.C. § 1464 (1989).

148. 42 U.S.C. § 1471 (1989).

States. HOLA defines residential property in section 1464(c)(5)(A) as follows:

> The terms "residential real property" or "residential real estate" mean leaseholds, homes (including condominiums and cooperatives, except that in connection with loans on individual cooperative units, such loans shall be adequately secured as defined by the Board), combinations of homes and business property, other dwelling units including homes and business property involving only minor or incidental business use, or property to be improved by construction of such structures.[149]

Unfortunately, no cases or regulations specify the amount or degree of "minor or incidental business use" that may be conducted on residential property before its "residential" character is lost. Nonetheless, section 1464(c)(5)(A) demonstrates that jurisdictions other than California recognize that hybrid property may qualify as "residential."

2. The Housing Act

The Housing Act is concerned with housing and dwellers, not with commercial agricultural production. This Act empowers the federal government, through the Secretary of Agriculture and the Farmers Home Administration, to "make and insure loans to enable rural *dwellers* otherwise unable to do so to purchase adequate *housing*."[150] The Housing Act also defines a residence with incidental agricultural income production as a residential farm. The statute reads:

> For the purpose of this subchapter, the term "farm" shall mean a parcel or parcels of land operated as a single unit which is used for the production of one or more agricultural commodities and which customarily produces or is capable of producing such commodities for sale and for home use of a gross annual value of not less than the equivalent of a gross annual value of $400 in 1944, as determined by the Secretary [of Agriculture].[151]

As with HOLA, neither cases nor regulations provide examples of the types of farmers the Housing Act intends to help. However, the small family farmer described throughout this Article seems to fall within the category of residential owners that the Act aims to assist, in spite of the incidental income produced from the residence.

Conclusion

This article attempts to demonstrate that residential property which supports incidental commercial activity can be classified as "residential"

149. 12 U.S.C. § 1464(c)(5)(A).
150. United States v. London, 550 F.2d 206, 209 (5th Cir. 1977) (emphasis added).
151. 42 U.S.C. § 1471(b)(1).

under section 580b. California and the Federal government have a strong policy of giving extra protection to residential property purchasers and homeowners. Given this strong policy, the Legislature and the courts may recognize that hybrid property under section 580b is "residential" if certain analytic criteria are met.

When considering whether hybrid property is residential, courts must look beyond the property itself. First, the court must examine the relationship between the borrower and the lender using the bargaining power and the risk of loss criteria. The court must next examine the relationship between the borrower and the property by considering the owner's intent and principal use of the property. Within the matrix of each relationship, these criteria must be compared and balanced to classify the hybrid property.

Deciding whether the hybrid family farm is "residential" or "commercial" within the meaning of section 580b cannot be done by simply focusing on the land itself, e.g., by quantifying the amount of acreage and/or income production on the property. Instead, the court must analyze the property using the four criteria. If the farmer: (1) was in a weak bargaining position; (2) was less capable of evaluating and shouldering the risk of default; (3) intended to use the property as a residence; and (4) principally used the farm as a residence, his property is "residential." If none of the above is true, the property should be deemed "commercial." If some of the criteria are satisfied and some are not, the court must balance the factors satisfied against those not satisfied to classify the property.

In the specific case of the small family farmer, it is important to recall that section 580b was enacted during the Great Depression when small farmers nearly became extinct. Therefore, today's courts should be mindful of the situation in 1933 and should apply the four criteria that this Article has formulated with a sense of equity and compasion when determining whether the small hybrid farm is "residential" or "commercial" under section 580b.