

Bucking Branco

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You have a meeting scheduled with your client, Harold, this afternoon to discuss setting up his estate plan. Harold is married to Wanda, who owns a home she acquired 10 years ago, a few months before they married. The only relevant debt is the original purchase money loan secured against Wanda's house. Since Harold and Wanda married, they have made the loan payments with their earnings. Harold is interested in determining if he has any community property rights in Wanda's home.

You know the *Moore/Marsden* analysis like the back of your hand and are prepared for the consultation.

The analysis will focus on the characterization of three distinct aspects of the equity in Wanda's home: (1) appreciation before marriage; (2) contributions to pay down the loan principal; and (3) appreciation after date of marriage.

Marriage of Aufmuth

In *Marriage of Aufmuth* (1979) 89 Cal.App.3d 446, a house was acquired in joint title during marriage in both spouses' names using wife's separate property for the down payment and community loan proceeds for the remainder of the purchase. The court found that, although the separate and community funds used to purchase the residence were "commingled," wife's separate interest was ascertainable. The court reimbursed the wife for her separate property down payment and reimbursed the community for the community principal payments.

The primary issue in *Aufmuth* was the apportionment of appreciation. The court found the apportionment should be based on the pro rata contributions of community and separate funds. Since wife contributed her separate property and the community loan paid for the rest of the purchase, wife's fractional interest in the appreciation was her down payment divided by the purchase price. The community's fractional interest was the initial loan amount divided by the purchase price.

Marriage of Lucas

Although the title presumption analysis in *Aufmuth* was later disapproved by the California Supreme Court in *Marriage of Lucas* (1980) 27 Cal.3d 808, the *Lucas* court specifically approved the *Aufmuth* formula as the means of apportioning appreciation on similar facts.



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Marriage of Moore

Two months later, in *Marriage of Moore* (1980) 28 Cal.3d 808, the California Supreme Court borrowed the *Aufmuth/Lucas* formula and adapted it to achieve an analogous result under different facts.

In *Moore*, the residence was acquired immediately before marriage using a separate property down payment and separate property loan proceeds. (There was no pre-marital appreciation.) The court awarded the community its contribution to the acquisition, which was the principal pay-down on the loan. The down payment was considered the separate property contribution.

The *Moore* decision is focused on apportioning the marital appreciation. Following the *Aufmuth/Lucas* rationale, the court found the community estate should receive a fractional interest in the appreciation determined by dividing the community principal payments by the purchase price. The separate property fractional interest in the marital appreciation was the separate property down payment plus the balance of the separate loan, divided by the purchase price. By including the loan in the numerator of the fraction, the *Moore* court applied the *Aufmuth/Lucas* rationale that the purchase money loan was an economic contribution toward the acquisition.

The *Moore* court noted the long history of California law recognizing that the community had a vested property interest in the residence—not merely an "equitable charge" as the trial court had found. The *Moore* court, like previous courts, rejected any theory that gave credit for payments towards non-purchase expenses (e.g., mortgage interest). The respective ownership interests are based on acquisition payments alone. As will be explained below, this ownership principle is important to remember, was reaffirmed in *Marriage of Branco* (1996) 47 Cal.App.4th

1621, and has also been recognized in other proceedings (e.g., probate and bankruptcy).

Marriage of Marsden

Marriage of Marsden (1982) 130 Cal.App.3d 426, unlike *Moore*, involved premarital appreciation. *Marsden* applied the *Moore* formula but gave the community an interest only in the marital appreciation since that was the only period during which community funds were used to purchase the residence. The pre-marital appreciation was confirmed as a separate property asset.

Meeting With Harold

During your meeting, you ask Harold the appropriate questions about the home, and get all the answers you need.

- Purchase Price: \$500,000
- Wanda’s SP Down Payment: \$100,000
- CP Principal Payments: \$ 15,000
- Current FMV: \$900,000
- Current Loan Balance: \$385,000
- Current Equity: \$515,000
- Marital Appreciation: \$400,000

You and Harold agree there was negligible appreciation in the value of Wanda’s house before marriage, so you disregard *Marsden* and go about performing a *Moore* analysis:

- CP Contributions: \$15,000
- CP Appreciation: $\frac{\$15,000}{\$500,000} \times \$400,000 = \$12,000$
- Total CP Interest: $\$15,000 + \$12,000 = \$27,000$
- SP Contributions: \$100,000
- SP Appreciation: $\frac{\$100,000 + \$385,000}{\$500,000} \times \$400,000 = \$388,000$
- Total SP Interest: $\$100,000 + \$388,000 = \$488,000$

You provide Harold with your *Moore* calculations. You show him that Wanda has a present separate property interest of \$488,000, that the community has an interest of \$27,000, and that the total equity in the home is \$515,000 (\$488,000 + \$27,000). Thus, Harold has a \$13,500 (\$27,000/2) interest in the home as his share of the com-

munity. Wanda’s separate and community interests total \$501,500 (\$488,000 + \$27,000/2).

Another Meeting With Harold—This Time Marriage of Branco

Several weeks later, Harold meets with you again. He is interested in obtaining a dissolution of marriage from Wanda, and tells you that they separated that day. Harold explains that the day after he last met with you Wanda refinanced her home loan, but other than that, nothing has changed as far as their financial situation is concerned. You know the *Marriage of Branco* refinance case like the back of your other hand.

In *Branco*, the wife acquired her house before marriage. During marriage, she refinanced her purchase money loan, thereby acquiring new loan proceeds, which were used to pay off her existing purchase money loan. The husband argued, and the *Branco* court agreed, the community should be considered to have “stepped into the shoes” of the wife’s prior loan to the extent the new loan paid off the previous loan. (*Branco, supra*, at p. 1625)

The new refinance loan proceeds were community in nature [see *Gudelj v. Gudelj* (1953) 41 Cal.2d 202, and *Marriage of Grinius* (1985) 166 Cal.App.3d 1179,]. Thus, the *Branco* court could “discern no meaningful difference” between the community loan proceeds being used to discharge the purchase money loan all at once, and the use of community funds to make loan payments over time. (*Branco, supra*, at p. 1627)

Accordingly, the *Branco* court gave the community credit for its unpaid loan balance in the appreciation formula.

You go through a *Branco* analysis with Harold:

- CP Contributions: \$15,000
- CP Appreciation: $\frac{\$15,000 + \$385,000}{\$500,000} \times \$400,000 = \$320,000$
- Total CP Interest: $\$15,000 + \$320,000 = \$335,000$
- SP Contributions: \$100,000
- SP Appreciation: $\frac{\$100,000}{\$500,000} \times \$400,000 = \$80,000$
- Total SP Interest: $\$100,000 + \$80,000 = \$180,000$

You provide Harold with your *Branco* calculations. You show him that Wanda has a present separate property interest of \$180,000, that the community has an interest of \$335,000, and that the total equity in the house is \$515,000 (\$180,000 + \$335,000). Thus, Wanda's separate and community interests total \$347,500 (\$180,000 + \$335,000/2) and Harold's community interest is \$167,500 (\$335,000/2).

How Can This Be?

Something seems askew. Only a few weeks ago, you confidently told Harold that pursuant to the *Moore* calculation Wanda owned a \$488,000 separate property interest in the equity in her house and a community property interest of \$13,500 (\$27,000/2), totaling \$501,500. You had assured Harold that it was a vested property interest and would be recognized in a probate proceeding, or even in bankruptcy.

Now, pursuant to the above *Branco* calculation, Wanda only has a \$180,000 separate property interest and a \$167,500 community property interest, totaling \$347,500. Before the refinance, Harold was only entitled to \$13,500 (\$27,000/2) as his one-half share of the community interest. Now, it would appear that \$167,500 (\$335,000/2) is the amount that Harold is entitled to for his one-half share.

However, as will be seen below, consideration of the *new community loan* is not over!

How did this happen? How, on a mere mathematical calculation, did Wanda apparently *lose* \$154,000 in her own home? How did Harold's community interest apparently go from \$13,500 to \$167,500?

Answer: The characterization of the marital appreciation shifted to favor the community. Before the "*Branco* refinance," there was a \$27,000 community interest in Wanda's home (\$13,500 to each party). After the refinance, it appears there is a \$335,000 community interest (\$167,500 to each party). All of this increase came from re-characterizing the past marital appreciation.

Harold asks, what happens to the loan? Is Wanda solely responsible for it? After all, since Wanda is likely to receive the house in the dissolution, she is likely to take the debt secured against the house.

In *Branco*, the husband argued that the wife should be solely responsible for the refinanced loan, since she was awarded the house. The court disagreed, finding that since the community was favored by the application of the *Moore* rule, the community should take on the very loan

that favored it in the appreciation calculation. Thus, the loan was a community obligation "to be shared equally between the parties." (*Branco, supra*, at p. 1629)

Without considering the math, this rationale does seem fair since the community just received a huge increase in the home. However, the math, in Harold's case, reveals the flaw in this rationale.

Wanda's refinance ended with a new community loan of \$385,000. Recall there are no other community debts and no community property other than the interest in the house. The calculation of the total community estate will be simple:

$$\begin{aligned} & \$335,000 \text{ (CP interest in Wanda's house) -} \\ & \$385,000 \text{ (CP house loan) = - } \langle \mathbf{\$50,000} \rangle \end{aligned}$$

You explain to Harold that not only is the community estate now *\$50,000 in the negative*, but, since Wanda will carry this debt, Harold is likely going to owe her an equalizing payment of \$25,000 for his share of the negative estate.

Several weeks ago, under *Marsden*, Harold was entitled to a \$13,500 interest in the home.

Under *Branco*, without a "double-dip" consideration of the new \$385,000 community loan, Harold appears to be entitled to a \$167,500 (\$335,000/2) interest in the home.

Now, due to Wanda's refinancing her loan (\$385,000) and giving it a "double-dip" consideration under *Branco*, Harold will apparently *owe* Wanda \$25,000.

The Marauding Ravages of Branco Double-Dipping

Harold is understandably confused. How could this happen? How could he be deprived of his community property interest by mere math? How could the community be in the negative, when the only change in math was the shifting of the loan from the separate interest numerator to the community interest numerator? Same result . . . right? No. Why? Double-dipping.

Not only does *Branco* improperly revise history by taking away from Wanda's separate property interest by reallocating past appreciation to the community, but it also takes the loan into account *twice*.

First, the loan reduces the overall equity in the residence. Recall that to determine the interests to be divided, the loan was deducted from the fair market value to determine the present equity.

Next, the loan is taken into account again in the division of the community estate. The new loan is considered a community debt that is used to calculate the total community estate. Recall that the *Branco* court would not

allow the loan to be considered solely wife's obligation, thereby taking it off the community balance sheet.

Is There A Branco Fix?

How do you fix the two problems?

The first problem—the revision in characterization of the appreciation—is a problem that is inherent in the *Moore* decision. Each community payment of loan principal gives the community a share in all prior appreciation. After all, appreciation is always allocated without respect to when community payments are made. This approach creates retroactive reallocation of appreciation after each community payment.

For example, imagine Wanda had used \$5 in community funds right after marriage to pay down principal on her home loan. Then, during the next ten years she paid down the principal by \$14,995 using her separate funds. A few weeks before separation, \$385,000 in community funds are used to pay off the outstanding loan. The practical effect of *Moore* is that the court would allocate a share in the marital appreciation to the community as if the \$385,005 in community contributions had been made on the first day of marriage. The community is late to invest in the house, but is nevertheless awarded most of the appreciation during marriage.

The Fix

There are three variables that factor into the calculation of the community's interest:

1. Time;
2. Fair Market Value (which varies depending on market forces); and,
3. CP Contributions (which vary depending on the parties' actions).

As to the first variable, time is constant.

As to the second variable, fair market value is hard to retrospectively analyze. If a court is presented with nothing more than the value at date of marriage and the value at date of trial, the court will have no idea how to determine the rate at which the increase in value occurred over time. A straight-line appreciation method should be used between each point at which the court has information as to value. This method assumes that market conditions, averaged over time, will result in an average appreciation rate. Unless more information is available to the court (e.g., an appraisal of the home several years into the mar-

riage), this method will reflect the best approximation of the progress of value.

As to the third variable, community contribution to the acquisition is easily determinable. The parties can refer to bank records or tax returns to determine how much the community paid towards the principal at any given time.

The only issue remaining is how to meld the three factors together into a fair apportionment of appreciation over time.

Periodic Valuation Approach

A periodic (monthly or annually) *Moore* approach will provide a stable approximation of time, straight-line value, and contribution. Under this approach, the *Moore* analysis is applied to the appreciation and contributions for each year of the marriage. For example, on an annual basis:

In year one, the community was an X% owner of the house, so it owns X% of the appreciation in that year; in year two, the community was an X + Y% owner of the house, so it owns X + Y% of the appreciation; and so on.

Although this periodic approach (monthly or annually) is similar in theory to valuing a defined contribution account [such as a 401(k)] where periodic values and community contributions can be determined relatively easily, it must be noted that such an approach for a house will probably be unavailable as a practical matter as the court would have to consider the value of the house each period (monthly/annually) during which a community principal payment was made—and while a house typically involves monthly/annual payments, there is no correlating monthly/annual report of value. The trial court would most likely find itself overburdened with the task of valuation, making the *Moore* approach of allocating appreciation at the time of division the only practical approach.

Balance Sheet Approach

The second problem—the loan “double-dip”—can easily be dealt with if the calculation of equity is determined in a balance sheet approach.

Referring back to the original values, when the community got a \$385,000 refinance loan, the proceeds of that loan should appear as a \$385,000 asset on the community balance sheet. Correspondingly, the \$385,000 loan should appear on the liability side of the balance sheet.

When determining the equity and characterization of the house, the separate and community balance sheets alone should be looked to.

Once the \$385,000 debt is accounted for, it should not again be included in the calculation of the community estate; the loan (liability) is absorbed into the proceeds (asset).

Wanda's Separate Estate Balance Sheet

<u>Asset</u>		<u>Liabilities</u>
House:		
Down Payment:	\$100,000	
Marital Appreciation:	<u>\$ 80,000</u>	
Total Assets:	\$180,000	Total Liabilities: 0
Net Separate Estate =	\$180,000	

Community Estate Balance Sheet

<u>Asset</u>		<u>Liabilities</u>
House:		New Home Loan: \$385,000
Principal Payments:	\$ 15,000	
New Loan Proceeds:	\$385,000	
Marital Appreciation:	<u>\$320,000</u>	
Total Assets:	\$720,000	Total Liabilities: \$385,000

Net Community Estate = \$335,000 (\$720,000 - \$385,000)

This balance sheet approach will protect the community investment and the essential intent of the *Branco* decision, though it will not strictly follow the language of the *Branco* decision. Should Wanda receive the house under the above balance sheet approach, she would receive \$347,500 (\$180,000 + \$335,000/2) and owe Harold an equalizing payment of \$167,500 (\$335,000/2).

Anybody trying to apply *Branco* should look to the practical realities of the *Branco* math rather than focus on what the *Branco* court tried to force—making the husband take partial responsibility for the community loan. As can be seen on a balance sheet, the husband has already taken on that responsibility by including it in the determination of the community's interest in the home. ■

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