

**OVERVIEW OF HOME EQUITY LOANS, HOME EQUITY LINES OF  
CREDIT, AND REVERSE MORTGAGE LENDING**

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Presented by TERRY L. GRANTHAM  
Prepared by ANGELIA B. LEE  
CRAIG, TERRILL, HALE & GRANTHAM, L.L.P.  
1500 Broadway, Suite 400  
Lubbock, Texas 79401  
(806) 744-3232 telephone  
(806) 744-2211 facsimile

## **BACKGROUND**

Homestead rights trace back to 1839 during Texas' days as a republic, prior to its admission into the Union.

In 1997, the 75<sup>th</sup> Texas Legislature adopted (and voters approved) a constitutional amendment allowing homeowners to borrow against the equity built up in their residences through home equity loans and reverse mortgages. Deficiencies with the law initially prevented a reverse mortgage market from developing in Texas, which were cured by 1999 changes to the Constitution.

In 2003, the 78<sup>th</sup> Texas Legislature adopted (and voters approved) a constitutional amendment which addressed certain concerns pertaining to home equity loans, and allowed home equity lines of credit.

In 2005, the 79<sup>th</sup> Texas Legislature adopted (and voters approved) a constitutional amendment which authorized line-of-credit advances under a reverse mortgage.

In 2007, the 80<sup>th</sup> Texas Legislature adopted (and voters approved) a constitutional amendment clarifying certain provisions relating to the making of a home equity loan and use of home equity loan proceeds.

During the 10 years from 1997 until now, borrowers, lenders, the interpretive agencies (the Office of the Consumer Credit Commissioner through its governing board, the Finance Commission, the Texas Department of Banking, the Texas Savings & Loan Department, and the Texas Credit Union Department), the Texas legislature, and the courts (both state and federal) all worked steadily to interpret what the Texas voters had REALLY meant when they approved home equity loans.

## **INTRODUCTION**

Home equity credit is a way homeowners can convert their home equity (which is the difference between the home's market value and its outstanding mortgage debt) into spendable funds.

Home equity credit is popular for several reasons:

1. Favorable tax treatment (interest is generally tax deductible).
2. Relatively low interest rates on HELs compared with most other forms of consumer credit.
3. Availability in time of crisis.
4. Large resource.

Traditional home equity loans– “HELs”– are closed-end loans extended for a specified length of time and requires repayment of interest and principal in equal periodic installments.

Home equity lines of credit– “HELOCs”– are revolving accounts that permits borrowing from time to time at the account holder's discretion up to the amount of the credit limit. HELOCs are subject to all the conditions of a HEL plus eight more requirements.

Reverse mortgages are so called because they work like conventional mortgages but in reverse. A reverse mortgage pays a homeowner in regular installments, a lump sum payment, or now through a line of credit that a homeowner can draw down as needed. Unlike the loan balance of a conventional mortgage, which becomes smaller with each monthly installment, the loan balance on a reverse mortgage grows larger over time. The loan principal increases with each payment received, and interest and other charges accrue each month on the total funds advanced. Reverse mortgages typically do not require repayment until the homeowner sells the home, conveys title or moves away, or dies.<sup>2</sup>

### THE AUTHORITY

The bodies of law and interpretations for both HELs, HELOCs, and Reverse Mortgages are:

1. The Constitution itself; TEX. CONST. ART. XVI, § 50, with the 2007 amendments underlined (Appendix A);
  - § 50– Entitled “Homestead: Protection from Forced Sale; Mortgages, Trust Deeds, and Liens”
  - § 50(a)-- Provides protection from forced sale
    - (1)-(5); (8) Exceptions to general restriction
      - (a)(1) purchase money;
      - (a)(2) taxes due thereon;
      - (a)(3) an owelty of partition resulting from a division of a family homestead in a divorce;
      - (a)(4) a refinance of a lien on the homestead, including a federal tax lien;
      - (a)(5) work and materials used in the construction of new improvements thereon or repair or renovation of existing improvements thereon; and

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<sup>2</sup>See, e.g., 12 C.F.R. § 226.33(a).

(a)(8) conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property.

§ 50(a)(6)	The subsection for HELs
§ 50(a)(7)	Authority for reverse mortgages without explanation
§ 50(b)-(j)	Assorted provisions, including the required notice provisions
§ 50(k) – (r)	Authority for reverse mortgages with explanation
§ 50(s)	Authorizing financial availability research
§ 50(t)	Authority for lines of credit
§ 50(u)	Agency authority
§ 50(v)	Reveres mortgage limitations

2. Sections of the Texas Administration Code, 7 TEX. ADMIN. CODE §153.01 *et seq.* (2007)(Appendix B);
3. The October 7, 1998 guidelines entitled "Regulatory Commentary on Equity Lending Procedures"—the Commentary--available at the OCC's website ([www.occ.state.tx.us](http://www.occ.state.tx.us)).(Appendix C);
4. *Texas Bankers Assoc. v. Assoc. of Community Org. for Reform Now (ACORN)*, pending in the 3<sup>rd</sup> Court of Appeals—Austin, 03-06-00273-CV (Appendix D);
5. Texas Rule of Civil Procedure 735 and 736.(Appendix E);
6. HUD Mortgage Letter 2006-06 (March 17, 2006) (Appendix F); and
7. Fannie Mae Reverse Mortgage Lender Letter 2006-2 (February 23, 2006)(Appendix G).

Administrative interpretive authority relating to home equity lending law is now granted to the Finance Commission, and to the Credit Union Commission for credit unions, with a safe harbor for lenders who conform to such interpretations. This authority also extends to home improvement loans and reverse mortgages.

Under Texas law, no mortgage, trust deed, or other lien may ever be properly fixed on the homestead unless it secures a type of indebtedness expressly authorized by the Texas Constitution under Sections 50(a)(1)-50(a)(8).

Homestead property is a place used as a home or as a place to exercise a calling or business for a family or a single, adult person. TEX. CONST. ART. XVI, § 50; TEX. PROP. CODE ANN. § 41.002 (Vernon 2007). Accordingly, certain residential real estate is homestead property (*e.g.*, property used

as primary residence), and other residential real estate property is not (e.g., vacation home, rental property).

## **VIOLATIONS AND CURES**

When a HEL violates the terms of section 50(a)(6), the lender forfeits the principal and interest (subject to a few specific cure provisions).

### **Incurable Violations.**

If the extension of credit is made by an entity or person other than an approved lending entity or person—no cure is available. *See* § 50(a)(6)(Q)(xi).

If the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents--no cure is available. *See* § 50(a)(6)(Q)(xi).

### **Curable Violations.**

For others, a 60-day period to cure is available under Section 50(a)(6)(Q)(x). As amended, Section 50(a)(6)(Q)(x) states:

...the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by:

- (a) paying to the owner an amount equal to any overcharge paid by the owner under or related to the extension of credit if the owner has paid an amount that exceeds an amount stated in the applicable Paragraph (E), (G), or (O) of this subdivision [§50(a)(6)]; [and/or]
- (b) sending the owner a written acknowledgement that the lien is valid only in the amount that the extension of credit does not exceed the percentage described by Paragraph (B) of this subdivision [§50(a)(6)], if applicable, or is not secured by property described under Paragraph (H) or (I) of this subdivision [§50(a)(6)], if applicable; [and/or]
- (c) sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by this section [§50(a)(6)(Q)] to a permitted amount, percentage, term, or other provision and adjusting the account of the borrower to

ensure that the borrower is not required to pay more than an amount permitted by this section [§50(a)(6)(Q)] and is not subject to any other term or provision prohibited by this section [§50(a)]; [and/or]

- (d) delivering the required documents to the borrower if the lender fails to comply with Subparagraph (v) of this paragraph [§50(a)(6)(Q)(x)] or obtaining the appropriate signatures if the lender fails to comply with Subparagraph (ix) [§50(a)(6)(Q)(x)] of this paragraph; [and/or]
- (e) sending the owner a written acknowledgement, if the failure to comply is prohibited by Paragraph (K) of this subdivision [§50(a)(6)(a)(6)], that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead; or [if (a)-(e) do not apply]
- (f) if the failure to comply cannot be cured under Subparagraphs (x)(a)--(e) of this paragraph, curing the failure to comply by a refund or credit to the owner of \$ 1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section.

Accordingly, the obligation to cure is triggered upon notice by the borrower of a lender's failure to comply. To correct a violation, the lender or holder must take one or more of the specific actions set out in subsections (Q)(x)(a)-(f), as applicable. Although the refinance of an equity loan before the first anniversary of the closing date of the loan is generally prohibited, Section 50(a)(6)(M)(iii) permits a refinancing made under these cure provisions.

## **HELs**

Section 50(a)(6) provides:

The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for an extension of credit that

### **Subsection A–Voluntary Lien, Written Agreement**

**(A)** is secured by a **voluntary lien** on the homestead created under a **written agreement** with the **consent of each owner and each owner's spouse**;

A lender may accept a properly executed power of attorney allowing the attorney-in-fact to execute closing documents on behalf of the owner. A lender may receive consent required under this section

by mail or other delivery of the party's signature to an authorized physical location and not the homestead. 7 TEX. ADMIN. CODE § 153.15 (2007).

**NO CURE:**

If the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents--no cure is available. *See § 50(a)(6)(Q)(xi)*. In this case, the lender forfeits the principal and interest.

**Subsection B–80% Limit**

**(B) is limited to 80 percent of the fair market value of the homestead;**

**CURE:**

If the principal amount of the loan at closing exceeds the 80% of the fair market value of the homestead property (when added to the aggregate balances of all other valid encumbrances of record), the lender or holder must send the owner a written acknowledgment that the lien is valid only in the amount that the extension of credit does not exceed the 80% amount.

**Subsection C–Without Recourse**

**(C) is without recourse for personal liability;**

**CURE:**

If the home equity loan contains provision prohibited by Section 50 (*e.g.*, recourse), the lender or holder must send the owner a written notice modifying this term (*e.g.*, make it without recourse) to a permitted term and adjust the account of the borrower (as necessary) to ensure that the borrower is not required to pay more than an amount permitted by section 50(a)(6)(Q) and ensure that the borrower is not subject to any other term or provision prohibited by section 50(a).

**Subsection D–Court Order Required for Foreclosure**

**(D) is secured by a lien that may be foreclosed upon only by a court order;**

**CURE:**

If the home equity loan contains any provision prohibited by Section 50 (*e.g.*, impermissible non-judicial foreclosure provision) the lender or holder must (i) send the owner a written

notice modifying the loan to conform to the term permitted by Section 50 (*e.g.*, provide the permissible judicial foreclosure provision), and (ii) adjust the account of the borrower (as necessary) to ensure that the borrower is not required to pay more than an amount permitted by section 50(a)(6)(Q) and ensure that the borrower is not subject to any other term or provision prohibited by section 50(a).

To obtain a court order to foreclose, the lender must follow the method set out in Texas Rules of Civil Procedure 735-736 (*see* Appendix E):

## **1. Application**

An application under Rule 736 must:

- a. Be verified;
- b. Be filed in the district court in any county where all or any part of the real property encumbered by the lien sought to be foreclosed (the "property") is located;
- c. Be styled: "In re: Order for Foreclosure Concerning (*Name of person to receive notice of foreclosure*) and (*Property Mailing Address*)";
- d. Identify by name the party who, according to the records of the holder of the debt, is obligated to pay the debt secured by the property;
- e. Identify the property by mailing address and legal description;
- f. Identify the security instrument encumbering the property by reference to volume and page, clerk's file number or other identifying recording information found in the official real property records of the county where all or any part of the property is located or attach a legible copy of the security instrument; and
- g. Allege that a debt exists which is secured by a HEL/HELOC or reverse mortgage (with supporting facts), that debt is in default, and that the applicant has given the requisite notices to cure the default, and that the lender has accelerated the maturity of the debt under the security instrument and applicable law.

## **2. Notice**

The application must be filed with the clerk of the court and be served by the party filing the application. Service of the application and notice shall be by delivery of a copy to the party to be served by certified and first class mail addressed to each party who, according to the records of the holder of the debt is obligated to pay the debt. Service shall be complete upon the deposit of the application and notice, enclosed in a postage prepaid and properly addressed

wrapper, in a post office or official depository under the care and custody of the United States Postal Service. If the respondent is represented by an attorney and the applicant's attorney has knowledge of the name and address of the attorney, an additional copy of the application and notice shall be sent to respondent's attorney.

The applicant or applicant's attorney shall certify to the court compliance with the service requirements of Rule 736. The applicant shall file a copy of the notice and the certificate of service with the clerk of the court. The certificate of service shall be prima facie evidence of the fact of service.

**Practice Note:** According to Rule 736, service is completed by the mailing—not by proof of receipt of the same by the homeowner. However, most judges in the area want to see (by the time of final hearing) that the homeowner has actual notice or if not, an explanation of what the lender has done to secure that notice. Suggestions include restricted signature for certified mail, regular mail in addition to certified mail, and posting of the application on the door of the house.

### **3. Response/Due Date.**

The respondent may file a response setting out as many matters, whether of law or fact, as respondent deems necessary or pertinent to contest the application. Such response and any supporting affidavit shall be made on personal knowledge and shall set forth such facts as would be admissible in evidence, provided that facts may be stated based upon information and belief if the grounds of such belief are specifically stated. The response shall state the respondent's mailing address. The response shall be filed with the clerk of the court. The respondent shall also send a copy of the response to the applicant or the applicant's attorney at the address set out in the notice.

A response is due **on or before 10:00 a.m. on the first Monday after the expiration of thirty-eight (38) days** after the date of mailing of the application and notice to respondent, exclusive of the date of mailing, as set forth in the certificate of service.

### **4. Default.**

At any time after a response is due, the court shall grant the application without further notice or hearing if: (A) the application complies with Rule 736(1); (B) the respondent has not previously filed a response; and (C) a copy of the notice and the certificate of service shall have been on file with the clerk of the court for at least ten days exclusive of the date of filing.

### **5. Hearing and Issue.**

On the filing of a response, the application shall be promptly heard after reasonable notice to the applicant and the respondent. No discovery of any kind shall be permitted in a proceeding

under Rule 736. Unless the parties agree to an extension of time, the issue shall be determined by the court not later than **ten** business days after a request for hearing by either party. At the hearing, the applicant shall have the burden to prove by affidavits on file or evidence presented the grounds for the granting of the order sought in the application.

The only issue to be determined under Rule 736 shall be the right of the applicant to obtain an order to proceed with foreclosure under the security instrument and Texas Property Code § 51.002.

**6. Order to Proceed with Notice of Sale and Sale.**

The court shall grant the application if the court finds applicant has proved the elements of Rule 736(1)(E). Otherwise, the court shall deny the application. The granting or denial of the application is not an appealable order.

The order shall recite the mailing address and legal description of the property, direct that foreclosure proceed under the security instrument and Texas Property Code § 51.002, provide that a copy of the order shall be sent to respondent with the notice of sale, provide that applicant may communicate with the respondent and all third parties reasonably necessary to conduct the foreclosure sale, and, if respondent is represented by counsel, direct that notice of the foreclosure sale date shall also be mailed to counsel by certified mail.

The applicant is to file a certified copy of the order in the real property records of the county where the property is located within ten business days of the entry of the order. Failure to timely record the order shall not affect the validity of the foreclosure or defeat the presumption of Texas Constitution, article XVI, § 50(i).

**Subsection E—Limitation of Fees**

**(E) does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit;<sup>3</sup>**

One of the most significant but difficult provisions of Section 50(a)(6) is the limit on the amount of fees that may be charged to make equity loans. Lenders may not charge or cause the borrower to pay fees in excess of 3% of the original principal amount of an equity loan (*e.g.* \$3,000 on a \$100,000 loan). The cap relates to any required fees that are necessary to originate, evaluate, maintain, record, insure, or service the loan.

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<sup>3</sup>Note that this section **was not** clarified by the 2007 Amendment.

Interest under this section is defined by 7 Texas Administrative Code section 153.1 as that “defined in the Texas Finance Code 301.002(4) and as interpreted by the courts,” which in turn is defined as:

compensation for the use, forbearance, or detention of money. The term does not include time price differential, regardless of how it is denominated. The term does not include compensation or other amounts that are determined or stated by this code or other applicable law not to constitute interest or that are permitted to be contracted for, charged, or received in addition to interest in connection with an extension of credit.

TEX, FIN CODE ANN. 301.002(4) (Vernon 2007).

The Texas Administrative Code § 153.5 provides interpretations pertaining to charges which are considered interest and not fees subject to the three percent fee limitation (*see* Appendix B):

“Points” is a term of art for what the lending industry uses to increase the yield for the lender. A point is 1% of the principal amount. Points may be charged to reduce an interest rate (“discount points”) or as a charge for the lender’s compensation for its work in funding the loan (“origination points.”) *Tarver v. Sebring Capital Credit Corp.*, 69 S.W.3d 708, 712-13 (Tex. App.-Waco 2002, no pet.).

Currently in Texas, “discount points” are not “fees” related to the origination of the loan for purposes of § 50(a)(6)(E), as long as the points are charged at the beginning of the loan term and were paid in consideration for a lower interest rate on the outstanding debt. *See Tarver*, (holding that discount points do not qualify as “fees” because they are not charged to “originate, evaluate, maintain, record, insure, or service the extension of credit.”)(citing TEX. CONST. ART. XVI, § 50(a)(6)(E)). Instead, such payments qualify as “interest” for purposes of § 50(a)(6)(E), even though both points and interest may be computed on the principal amount of the loan. *Id.*; *accord, Pelt v. U.S. Bank Trust Nat. Ass’n*, 2002 WL 31006139\*4 (N.D.Tex. 2002).

However, this interpretation is up for discussion. ACORN’s Judge Jenkins informed the parties on how he intended to rule in an October 7, 2005 letter (*see* Appendix D):

Under the agencies' rules, and in particular Rule 153.5(3), a lender could charge a point to originate the loan, a point to evaluate the loan, a point to maintain the loan, and a point to service the loan, and even though none of those points bore any relationship to the monthly interest rate being charged to the borrower, they would not be subject to the three percent cap. In fact, it would not matter whether any of these charges were in the form of points. Because all of these charges by the lender are considered, at present, interest (as that term is technically defined in usury law), they are not subject to the three percent fee cap. Because this seems so contrary to the clear language, purpose and intent of Article 16, Section 50(a)(6)(E), I have decided to rule for the Plaintiffs on this point.

The decision may impact whether origination fees and points are within the three percent fee limit. The Final Summary Judgement Order may support the conclusion that they are. Other cases and Judge Jenkins' letter reflect a position that discount points (*i.e.*, points paid for reducing the interest rate) are a form of interest and, therefore, not fees within the three percent limit. Nonetheless, the order may create uncertainty on this issue.

Loan Amount	Interest rate (not capped)	Origination point(s) Fees and therefore Capped at 3% §50(a)(6)(E)	Discount point(s)  Interest and therefore <b>Not Capped</b> at 3% 7 Tex. Admin. Code § 153.5(3) (2007) & <i>Tarver</i> ;  Not Interest and therefore <b>Capped</b> at 3%—ACORN district court	Cost of Loan  simple interest (as example only) plus points
80K	10%	0	0	\$8,000
80K	8.5%	1 point \$800 (1%)	1 point \$800 (1%)	\$8,400 (\$6,800 interest plus \$1,600 in points) <b>within 3% cap either way</b>
80K	8.5%	2 points \$1,600 (2%)	2 points \$1,600 (2%)	\$10,000 (\$6,800 interest plus \$3,200 in points) <b>not allowed under ACORN</b>

**BOTTOM LINE:** Lenders should take care while using points and not subjecting them to the 3% cap until the 3<sup>rd</sup> Circuit Court rules on ACORN.

**CURE:**

If the owner has paid an amount to the lender or holder that exceeds the 3% fee cap the lender or holder must pay to the owner an amount of money equal to any such overcharge.

**Subsection F-No Open-End Accounts Except a HELOC**

**(F) is not a form of open-end account that may be debited from time to time or under which credit may be extended from time to time unless the open-end account is a home equity line of credit;**

**Subsection G-Payable in Advance Without Charge**

**(G) is payable in advance without penalty or other charge;**

**CURE:**

If the owner has paid an amount to the lender or holder that is a prohibited prepayment penalty, the lender or holder must pay to the owner an amount of money equal to any such overcharge.

**Subsection H-Additional Property**

**(H) is not secured by any additional real or personal property other than the homestead;**

**CURE:**

If the loan purports to be secured by any real or personal property other than the homestead property as additional collateral prohibited by Subsection (a)(6)(H), the lender or holder must send the owner a written acknowledgment that the loan is not secured by any impermissible property.

**Subsection I-Dairy Farms**

**(I) is not secured by homestead property that on the date of closing is designated for agricultural use as provided by statutes governing property tax, unless such homestead property is used primarily for the production of milk;<sup>4</sup>**

A borrower may not have a HEL secured by a homestead property designated for agricultural use as provided by statutes governing property tax<sup>5</sup> unless it is a dairy farm.

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<sup>4</sup>Note that this section **was** clarified by the 2007 Amendment in regard to the timing of the designation. Prior to this clarification, the section did not include the underlined text.

<sup>5</sup>TEX. PROP. TAX CODE ANN. Chapter 23, subchapters C & D.

This amendment in effect overruled in part the decision in *Marketic v. U.S. Bank Nat'l Ass'n*, 436 F. Supp. 2d 842 (N.D. Tex. 2006), where the court decided that homestead property, if subsequently designated for agricultural use by a borrower of a home equity loan, is protected from forced sale under Section 50(a)(6)(I), regardless of how the property was designated when the borrower incurred the debt.

The issue of equitable subrogation arose under this subsection prior to the 2007 Amendment. In *LaSalle Bank National Ass'n v. White*, the Texas Supreme Court held that the bank was entitled to equitable subrogation for the portion of the home equity loan proceeds used to pay the borrower's purchase money lien and outstanding property taxes. After a bench trial, the district court determined that *LaSalle Bank National Ass'n* (the Bank) had extended a HEL to White for non-dairy homestead property designated for agricultural use. The district court went further to forfeit all the principal and interest owed to the Bank, including the "refinanced portion" (that amount used to pay off permissible purchase money liens and permissible tax liens) and the "cash-out portion" (that portion kept by White). Although the San Antonio Court of Appeals agreed that all the HEL funds were subject to the forfeiture, the Supreme Court reversed.

**CURE:**

If the loan purports to be secured by any homestead property designated for agricultural use prohibited by Subsection (a)(6)(I), the lender or holder must send the owner a written acknowledgment that the loan is not secured by any impermissible agricultural property.

**Subsection K—Only One Equity Loan at a Time**

**(K) is the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Subsections (a)(1)-(a)(5) or Subsection (a)(8) of this section;<sup>6</sup>**

A homestead may be encumbered with only one equity loan at a time. Any other debt concurrently secured by the homestead must be one of the other types of permitted encumbrances specified in the Texas Constitution. The cited subsections generally provide the following exceptions to the prohibition on the forced sale of the homestead for the payment of debts:

- (a)(1) purchase money;
- (a)(2) taxes due thereon;
- (a)(3) an owelty of partition resulting from a division of a family homestead in a divorce;
- (a)(4) a refinance of a lien on the homestead, including a federal tax lien;

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<sup>6</sup>Note that this section **was not** clarified by the 2007 Amendment.

- (a)(5) work and materials used in the construction of new improvements thereon or repair or renovation of existing improvements thereon; and
- (a)(8) conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property.

Subsections (a)(6) and (a)(7) are not listed. Accordingly, an equity loan may not encumber a homestead that is also encumbered by an equity loan, a debt described and lien authorized by Section 50(a)(6), or a reverse mortgage, a debt described and lien authorized by Section 50(a)(7). HELOCs are a type of equity loan. Accordingly, a borrower may have either an equity loan or a HELOC, but not both.

**CURE:**

A failure to comply with Subsection(K) is significant. If the lender has made an equity loan on a homestead property that already has an equity loan secured on the same property made under Subsection (a)(6) or a reverse mortgage secured on the same property made under Subsection (a)(7) in violation of Subsection (a)(6)(K), the lender or holder must send the owner a written acknowledgment that the accrual of interest and all of the owner's obligations under the loan are abated while any such prior (a)(6) or (a)(7) lien remains secured by the same homestead property.

**Subsections L and O Payments/Fixed or Variable Rates**

**(L) is scheduled to be repaid: (i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment; or (ii) if the extension of credit is a home equity line of credit, in periodic payments described under Subsection (t)(8) of this section; [and] (O) permits a lender to contract for and receive any fixed or variable rate of interest authorized under statute;<sup>7</sup>**

Prior to 2003, a home equity loan had to be repaid in substantially equal successive monthly installments beginning no later than two months after the date the loan is made. Repayment is now authorized in substantially successive periodic installments, not more often than every 14 days and not less often than monthly.<sup>8</sup> Thus, biweekly payments are now authorized. All accrued interest must be paid with each installment. This restriction effectively prohibits balloon or negative amortizing notes.<sup>31</sup> An interpretation states, "Section50(a)(6)(L)(i) does not preclude a lender's recovery of

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<sup>7</sup>Note that these sections **were not** clarified by the 2007 Amendment.

<sup>8</sup>7 TEX. ADMIN. CODE § 153.16 (2007).

payments as necessary for other amounts such as taxes, adverse liens, insurance premiums, collection costs, and similar items.”<sup>9</sup>

The requirement pertaining to repayment in substantially equal successive periodic installments raises an issue with respect to variable rate loans because a normal feature of variable rate real estate loans is that the payments vary as the interest rate varies (or on some other schedule) to insure that the loan amortizes.

To give both these sections meaning, a lender may have to structure a variable rate loan with level payments and no negative amortization, but provide that the number of payments will vary until the loan is paid off.

**BOTTOM LINE** A lender may need to structure a variable rate loan with level payments, no negative amortization and provide that the number of payments will vary until the loan is paid off in order to give both Sections 50(a)(6)(L)(i) (*i.e.*, substantially equal successive periodic installments requirement) and 50(a)(6)(O) (*i.e.*, variable rate authority) meaning.

#### **CURE:**

If the home equity loan contains provision prohibited by Section 50 (*e.g.*, impermissible repayment schedule), the lender or holder must send the owner a written notice modifying this term (*e.g.*, correct the schedule) to a permitted term and adjust the account of the borrower (as necessary) to ensure that the borrower is not required to pay more than an amount permitted by section 50(a)(6)(Q) and ensure that the borrower is not subject to any other term or provision prohibited by section 50(a).

#### **Subsection M (i-ii): Timing of Closing Date & Disclosure Review Period**

**(M) is closed not before: (i) the 12th day after the later of the date that the owner of the homestead submits a loan [an] application to the lender for the extension of credit or the date that the lender provides the owner a copy of the notice prescribed by Subsection (g) of this section; (ii) one business day after the date that the owner of the homestead receives a copy of the loan application if not previously provided and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing; and (iii)[see below]<sup>10</sup>**

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<sup>9</sup>7 TEX. ADMIN. Code § 153.11(2) (2007).

<sup>10</sup>Note that this section **was** clarified by the 2007 Amendment as indicated by the underlined text.

The 2007 amendment “clarification” may effectively overrule the Texas Administration Code interpretation of this section, which provides “a loan application may be given orally or electronically.”<sup>11</sup>

This amendment requiring a written loan application is consistent with the ruling of Judge Jenkins in ACORN.<sup>12</sup> The underlined language in (ii) indicates that the loan application has to be in a form that the lender can return to homeowner, again indicating a written application.

A preclosing disclosure of the final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing is required, and with the clarification now the lender must also provide a copy of the loan application at this preclosing disclosure if it had not previously been provided.<sup>13</sup>

A lender may satisfy the disclosure requirement of this section by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A.

Chapter 7, Texas Administrative Code section 153.13 sets out the interpretation of what is required for preclosing disclosures and what constitutes valid reasons that the lender may modify previously provided documentation on the date of closing. Judge Jenkins in ACORN criticized the “poorly drafted” interpretation in his October 2005 letter.<sup>14</sup> In apparent response, the Commissions repealed the interpretation and issued a new one which clarifies “bona fide emergency” and “other good cause” by setting out principals and examples of these terms.<sup>15</sup>

The term “de minimis” as used in this section means a very small or insignificant amount, and at the owner's election means that the total actual aggregate fees, costs, points, and charges on the date of closing do not exceed more than either \$100 or 0.125 percent of the principal amount of the loan (whichever is greater) and (ii) no itemized fee, cost, point, or charge exceeds more than the greater of \$100 or 0.125 percent of the principal amount of the loan that the amount disclosed in the initial preclosing disclosure.

Accordingly, certain lenders may address the disclosure requirement by delivery of a HUD-1 (or HUD-1A) settlement statement to the borrower. As with the Notice, a lender should establish

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<sup>11</sup>7 TEX. ADMIN. CODE § 153.12(2) (2007).

<sup>12</sup>See Appendix D, D-6.

<sup>13</sup>7 TEX. ADMIN. CODE § 153.12 (2007).

<sup>14</sup>See Appendix D, D-3.

<sup>15</sup>7 TEX. ADMIN. CODE § 153.13 (2007).

procedures to verify the owner receives the preclosing disclosure. A lender may consider requiring the preclosing disclosure be signed and dated to aid in documenting the date of an owner's receipt of the disclosure.

In practice, actual fees and charges often are not known until the lender's closing instructions and invoices from third-party settlement service providers are received by the settlement agent responsible for preparing the settlement statement – often right before a scheduled closing.

### **CURE:**

If the lender when making an equity loan has failed to comply with any constitutional obligation that cannot be cured under any of the subdivisions 50(a)(6)(Q)(x)(a) – (e), the lender or holder may cure the failure to comply by (i) a refund or credit to the owner of \$1,000, and (ii) offering the owner the right to refinance the equity loan with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original equity loan, with any modifications in terms necessary for the loan to comply with Section 50, or on such terms as the lender or holder and the owner otherwise agree that comply with Section 50.155 Although the refinance of an equity loan before the first anniversary of the closing date of the loan is generally prohibited, Section 50(a)(6)(M)(iii) permits a refinancing made under the cure provisions of Section 50(a)(6)(Q)(x)(f).

### **Subsection M (iii): Refinancing Limitation**

**(M) is closed not before: [the above subsection] AND (iii) the first anniversary of the closing date of any other extension of credit described by Subsection (a)(6) of this section secured by the same homestead property, except a refinance described by Paragraph (Q)(x)(f) of this subdivision, unless the owner on oath requests an earlier closing due to a state of emergency that: (a) has been declared by the president of the United States or the governor as provided by law; and (b) applies to the area where the homestead is located;**<sup>16</sup>

Prior to the 2007 clarification, a homeowner could not refinance a HEL for one year following closing except to cure a lender's "failure to comply" violation as described paragraph 50(a)(6)(Q)(x)(f). With the clarification, refinancing is also available in state of emergency situations. Still, the availability of refinancing is a HEL is very, very limited.

Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification is a transaction in which one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A modification of an

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<sup>16</sup>Note that this section **was** clarified by the 2007 Amendment as indicated by the underlined text.

equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law (such as a modification required under the Soldiers' and Sailors' Civil Relief Act).

The advance of additional funds to a borrower is not permitted by modification of an equity loan, and a modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.<sup>17</sup>

**CURE:**

If the lender when making an equity loan has failed to comply with any constitutional obligation that cannot be cured under any of the subdivisions 50(a)(6)(Q)(x)(a) – (e), the lender or holder may cure the failure to comply by (i) a refund or credit to the owner of \$1,000, and (ii) offering the owner the right to refinance the equity loan with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original equity loan, with any modifications in terms necessary for the loan to comply with Section 50, or on such terms as the lender or holder and the owner otherwise agree that comply with Section 50.155 Although the refinance of an equity loan before the first anniversary of the closing date of the loan is generally prohibited, Section 50(a)(6)(M)(iii) permits a refinancing made under the cure provisions of Section 50(a)(6)(Q)(x)(f).

**Subsection N: Closing Site**

**(N) is closed only at the office of the lender, an attorney at law, or a title company;**

**CURE:**

If the lender when making an equity loan has failed to comply with any constitutional obligation that cannot be cured under any of the subdivisions 50(a)(6)(Q)(x)(a) – (e), the lender or holder may cure the failure to comply by (i) a refund or credit to the owner of \$1,000, and (ii) offering the owner the right to refinance the equity loan with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original equity loan, with any modifications in terms necessary for the loan to comply with Section 50, or on such terms as the lender or holder and the owner otherwise agree that comply with Section 50.155 Although the refinance of an equity loan before the first anniversary of the closing date of the loan is generally prohibited, Section 50(a)(6)(M)(iii) permits a refinancing made under the cure provisions of Section 50(a)(6)(Q)(x)(f).

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<sup>17</sup> TEX. ADMIN. CODE § 153.14 (2007).

### Subsection P: Lender Restrictions

- (P) is made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area:
- (i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States;
  - (ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;
  - (iii) a person licensed to make regulated loans, as provided by statute of this state;
  - (iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase;
  - (v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity; or
  - (vi) a person regulated by this state as a mortgage broker;

### NO CURE

If the extension of credit is made by a person other than an approved lending entity or person—no cure is available. See § 50(a)(6)(Q)(xi). In this case, the lender forfeits the principal and interest.

### Subsection Q: Application of Proceeds/Voluntary Debt Consolidation

(Q) is made on the condition that: (i) the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender;<sup>18</sup>

The voluntary requirement is reiterated in the Administrative Code:

An equity loan must be made on the condition that the owner of the homestead **is not required** to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender.

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<sup>18</sup>Note that this section **was not** clarified by the 2007 Amendment.

(1) The lender **may not require** an owner to repay a debt owed to the lender, unless it is a debt secured by the homestead. The lender may require debt secured by the homestead or debt to another lender or creditor be paid out of the proceeds of an equity loan.

(2) An owner may apply for an equity loan for any purpose. **An owner is not precluded from voluntarily using the proceeds of an equity loan to pay on a debt owed to the lender making the equity loan.**

7 TEX. ADMIN. CODE § 153.18 (2007)(emphasis added).

In *In re Box*, 324 B.R. 290 (Bankr. S.D. Tex. 2005), a bankruptcy court concluded a bank's lien on the borrowers' homestead is unenforceable because the bank “required” the borrowers to apply the proceeds to a debt with the bank even though the borrowers signed various documents stating that they were not required to apply the loan proceeds to any debt held by the bank. *Id.* at 291. The court found that the unambiguous intent of the parties was for the HEL to collateralize the antecedent debt to the bank. The court also found that, even though both parties made copious recitals to the contrary, the bank required and the debtors agreed that the debtors were required to apply the HEL to their antecedent debt.

The U.S. District Court for the Southern District of Texas, Houston Division, has affirmed the bankruptcy court's order. *See Box v. First State Bank*, 340 B.R. 782 (S.D. Tex. 2006). While section 50(a)(6)(Q)(i) **allows** a borrower voluntarily to agree to use home-equity loan proceeds to repay a prior unsecured debt to the same lender, the court states

The undisputed evidence in this case showed that the lender restricted the borrower's use of home-equity loan proceeds – to repay the existing unsecured debt owed to the same lender – when it agreed to make the loan only if the borrower specified this use.

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When, as here, the record contains undisputed evidence that the lender would not have made the home-equity loan unless the homestead owner agreed to restrict the proceeds to repaying prior unsecured debt owed to the same lender, the lender is requiring this restricted use of proceeds. ... If, on the other hand, the Bank had presented evidence that it was willing to make the loan even if the proceeds had been paid directly to the borrower, without restriction, the fact that the borrower agreed to use the proceeds to repay the existing debt would not invalidate the lien.

*Id.* at 788.

**BOTTOM LINE:** A lender must use caution to ensure that the payment is truly voluntary. The Commentary recommends that “a lender should obtain a signed acknowledgment from the owner evidencing the borrower's voluntary repayment of any existing debt if the owner directs that the proceeds should be disbursed directly to existing creditors.”

Fannie Mae also recommends that a lender document the voluntary nature of the payment, for example, by requiring the borrower to sign a statement to that effect. Many practitioners have developed a document or incorporated into their documents language evidencing the voluntary nature of such repayments.

According to *Box*, however, the lender should also document its file that it would have extended the HEL to the borrower regardless of the borrower's intention to repay any existing debt to this lender.

### CURE

If the home equity loan contains any provision prohibited by Section 50 (*e.g.*, impermissible repayment requirements) the lender or holder must (i) send the owner a written notice modifying the loan to conform to the term permitted by Section 50 (*e.g.*, provide the permissible repayment provision), and (ii) adjust the account of the borrower (as necessary) to ensure that the borrower is not required to pay more than an amount permitted by section 50(a)(6)(Q) and ensure that the borrower is not subject to any other term or provision prohibited by section 50(a).

### **HELOCs**

“HELOCs” are authorized under Section 50(a)(6)(F), which provides that open-end accounts are prohibited “unless the open-end account is a home equity line of credit.”

Section 50(t) defines an authorized Texas HELOC as “form of an open-end account that may be debited from time to time, under which credit may be extended from time to time.”

Section 50(t) then lists eight (8) requirements to which HELOCs are subject to in addition to the conditions of Section 50(a)(6) applicable to other Texas HELs, except as modified by Section 50(t)<sup>19</sup>:

A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

- (1) the owner requests advances, repays money, and reborrows money;
- (2) any single debit or advance is not less than \$ 4,000;
- (3) the owner does not use a credit card, debit card, [~~preprinted solicitation check,~~] or similar device, or preprinted check unsolicited by the borrower, to obtain an advance;

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<sup>19</sup>Note that this section **was** amended in 2007 as indicated.

- (4) any fees described by Subsection (a)(6)(E) of this section are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance;
- (5) the maximum principal amount that may be extended under the account, when added to the aggregate total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, does not exceed an amount described under Subsection (a)(6)(B) of this section;
- (6) no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established;
- (7) the lender or holder may not unilaterally amend the extension of credit; and
- (8) repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and:
  - (A) during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and
  - (B) after the period during which the owner may request advances, installments are substantially equal.

The Administrative Code provides

- (1) A lender may offer one or more non-prohibited devices or methods for use by the owner to request an advance. Permissible methods include contacting the lender directly for an advance, telephonic fund transfers, and electronic fund transfers. Examples of devices that are not prohibited similar devices include prearranged drafts, **convenience checks**, or written transfer instructions.

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- (4) A preprinted solicitation check, which is a prohibited device under Section 50(t)(3), is a check that:
  - (A) is provided to an owner for the purpose of originating a HELOC or to a borrower for the purpose of soliciting additional advances on an existing HELOC;
  - (B) contains at least one preprinted key payment term, such as the amount or payee; and

(C) is not requested by the borrower or owner.

7 TEX. ADMIN. CODE § 153.84 (2007)(emphasis added).

IN ACORN, Judge Jenkins criticized 153.84(1) and specifically its approval of convenience checks as acceptable manner of obtaining an advance.<sup>20</sup> Convenience checks are special checks issued by lenders to borrowers, allowing the borrowers to write the check against a line of credit. The only requirement of the borrower is to sign the “check.” (*United State of America v. Smith*, 2007 US App Lexis 15700—usually unsolicited and with all the terms and conditions predetermined by the lender.)

Perhaps in response to Judge Jenkins, the 2007 amendment clarified 50(t) as indicated by the edited language above to effectively overrule the Texas Administrative Code. This language likewise applies to reverse mortgage lines of credits, discussed below.

### REVERSE MORTGAGES

Texas Constitution article XVI, § 50(a)(6) outlines the requirements for HELs. Likewise, § 50(a)(7) gives a “one line” authority for reverse mortgages without explanation, and § 50(k) – (r) outlines the requirements for reverse mortgages:with explanation. Some of the requirements are the same. For example, both must be “secured by a voluntary lien on homestead property created by a written agreement with the consent of each owner and each owner's spouse.” However, the **authority** for that requirement is found in separate subsections of §50. Absent from the reverse mortgage section, for example, is the 80 percent loan to value cap and the three percent fee limit.

Reverse mortgages are an important financial tool for many older homeowners who describe themselves as “house rich and cash poor.” Unlike the traditional home mortgage loan, a reverse mortgage is underwritten based upon the home's appraised value and the loan term or actuarial life expectancy of the owner, and not upon the income or earning capacity of the owner, who is most often retired and living on a fixed income. Actuarial formulas are used to determine life expectancy rates for purposes of determining the principal loan limit, which cannot exceed the expected value of the home at loan maturity.

In Texas, the authority for reverse mortgages is set forth in Section 50(a)(7) and Sections 50(k) – (r).

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<sup>20</sup>See Appendix D, D-3,

Section 50(k) provides:

“Reverse mortgage” means an extension of credit:

**Subsection 1–Voluntary Lien, Written Agreement**

- (1) that is secured by a voluntary lien on homestead property created by a written agreement with the consent of each owner and each owner's spouse;

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**Subsection 2–Age Requirement of 62 years**

- (2) that is made to a person who is or whose spouse is 62 years or older;

Generally, the younger the borrower, the lower the monthly payments for which the borrower qualifies because payments generally must be disbursed over a longer period than with an older borrower.

**Subsection 3–Without Recourse**

- (3) that is made without recourse for personal liability against each owner and the spouse of each owner;

**Subsection 4–Equity-Based Advances**

- (4) under which advances are provided to a borrower based on the equity in a borrower's homestead;

**Subsection 5–No Reduction Based Upon Interest Rates**

- (5) that does not permit the lender to reduce the amount or number of advances because of an adjustment in the interest rate if periodic advances are to be made;

**Subsection 6–No Payment of Principal/Interest**

- (6) that requires no payment of principal or interest until:
  - (A) all borrowers have died;
  - (B) the homestead property securing the loan is sold or otherwise transferred;
  - (C) all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval from the lender; or

- (D) the borrower:
- (i) defaults on an obligation specified in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property
  - (ii) commits actual fraud in connection with the loan; or
  - (iii) fails to maintain the priority of the lender's lien on the homestead property, after the lender gives notice to the borrower, by promptly discharging any lien that has priority or may obtain priority over the lender's lien within 10 days after the date the borrower receives the notice, unless the borrower:
    - (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to the lender;
    - (b) contests in good faith the lien by, or defends against enforcement of the lien in, legal proceedings so as to prevent the enforcement of the lien or forfeiture of any part of the homestead property; or
    - (c) secures from the holder of the lien an agreement satisfactory to the lender subordinating the lien to all amounts secured by the lender's lien on the homestead property;

**Subsection 7–Forfeiture of Principal/Interest Upon Lender’s Default**

- (7) that provides that if the lender fails to make loan advances as required in the loan documents and if the lender fails to cure the default as required in the loan documents after notice from the borrower, the lender forfeits all principal and interest of the reverse mortgage, provided, however, that this subdivision does not apply when a governmental agency or instrumentality takes an assignment of the loan in order to cure the default;

**Subsection 8–Counseling Required**

- (8) that is not made unless the owner of the homestead attests in writing that the owner received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives;

**Subsection 9–Written Notice/Disclosure**

- (9) that requires the lender, at the time the loan is made, to disclose to the borrower by written notice the specific provisions contained in Subdivision (6) of this subsection under which the borrower is required to repay the loan;

**Subsection 10–Right to Cure**

- (10) that does not permit the lender to commence foreclosure until the lender gives notice to the borrower, in the manner provided for a notice by mail related to the foreclosure of liens under Subsection (a)(6) of this section, that a ground for foreclosure exists and gives the borrower at least 30 days, or at least 20 days in the event of a default under Subdivision (6)(D)(iii) of this subsection, to:
- (A) remedy the condition creating the ground for foreclosure;
  - (B) pay the debt secured by the homestead property from proceeds of the sale of the homestead property by the borrower or from any other sources; or
  - (C) convey the homestead property to the lender by a deed in lieu of foreclosure; and

**Subsection 11–Foreclosure by Court Order**

- (11) that is secured by a lien that may be foreclosed upon only by a court order, if the foreclosure is for a ground other than a ground stated by Subdivision (6)(A) or (B) of this subsection.

Sections 50(l)-(m) provide:

**Section L–Advances**

- (1) Advances made under a reverse mortgage and interest on those advances have priority over a lien filed for record in the real property records in the county where the homestead property is located after the reverse mortgage is filed for record in the real property records of that county.

**Section M–Variable/Fixed Interest Rate; Accrued/Compoundable**

- (m) A reverse mortgage may provide for an interest rate that is fixed or adjustable and may also provide for interest that is contingent on appreciation in the fair market value of the homestead property. Although payment of principal or interest shall not be required under a reverse mortgage until the entire loan becomes due and payable, interest may accrue and be compounded during the term of the loan as provided by the reverse mortgage loan agreement.

**Section N–Exceptions to State Law**

- (n) A reverse mortgage that is secured by a valid lien against homestead property may be made or acquired without regard to the following provisions of any other law of this state:

- (1) a limitation on the purpose and use of future advances or other mortgage proceeds;
- (2) a limitation on future advances to a term of years or a limitation on the term of open-end account advances;
- (3) a limitation on the term during which future advances take priority over intervening advances;
- (4) a requirement that a maximum loan amount be stated in the reverse mortgage loan documents;
- (5) a prohibition on balloon payments;
- (6) a prohibition on compound interest and interest on interest;
- (7) a prohibition on contracting for, charging, or receiving any rate of interest authorized by any law of this state authorizing a lender to contract for a rate of interest; and
- (8) a requirement that a percentage of the reverse mortgage proceeds be advanced before the assignment of the reverse mortgage.

#### **Section O—Assistance Program Eligibility**

- (o) For the purposes of determining eligibility under any statute relating to payments, allowances, benefits, or services provided on a means-tested basis by this state, including supplemental security income, low-income energy assistance, property tax relief, medical assistance, and general assistance:
  - (1) reverse mortgage loan advances made to a borrower are considered proceeds from a loan and not income; and
  - (2) undisbursed funds under a reverse mortgage loan are considered equity in a borrower's home and not proceeds from a loan.

Significantly, loan advances made to the homeowner under a reverse mortgage generally are not taxable as income and do not affect the homeowner's eligibility for Social Security, Medicare and Medicaid benefits. However, a borrower electing a lump-sum advance of proceeds should seek counseling regarding their continued eligibility for Medicaid benefits if retaining the advance as a liquid resource.

### **Section P–Methods for Advances**

- (p) The advances made on a reverse mortgage loan under which more than one advance is made must be made according to the terms established by the loan documents by one or more of the following methods:
- (1) an initial advance at any time and future advances at regular intervals;
  - (2) an initial advance at any time and future advances at regular intervals in which the amounts advanced may be reduced, for one or more advances, at the request of the borrower;
  - (3) an initial advance at any time and future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached;
  - (4) an initial advance at any time, future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance is repaid; or
  - (5) at any time by the lender, on behalf of the borrower, if the borrower fails to timely pay any of the following that the borrower is obligated to pay under the loan documents to the extent necessary to protect the lender's interest in or the value of the homestead property:
    - (A) taxes;
    - (B) insurance;
    - (C) costs of repairs or maintenance performed by a person or company that is not an employee of the lender or a person or company that directly or indirectly controls, is controlled by, or is under common control with the lender;
    - (D) assessments levied against the homestead property; and
    - (E) any lien that has, or may obtain, priority over the lender's lien as it is established in the loan documents.

### **Section Q–Exception to Homestead Encumbrances**

- (q) To the extent that any statutes of this state, including without limitation, Section 41.001 of the Texas Property Code, purport to limit encumbrances that may properly be fixed on homestead property in a manner that does not permit encumbrances for extensions of credit described in Subsection (a)(6) or (a)(7) of this section, the same shall be superseded to the extent that such encumbrances shall be permitted to be fixed upon homestead property in the manner provided for by this amendment.

### **Section R–Expedited Foreclosure with Court Order**

- (r) The supreme court shall promulgate rules of civil procedure for expedited foreclosure proceedings related to the foreclosure of liens under Subsection (a)(6) of this section and to foreclosure of a reverse mortgage lien that requires a court order.

### **Section V–Methods of Payment**

- (v) A reverse mortgage must provide that:
- (1) the owner does not use a credit card, debit card, preprinted solicitation check, or similar device to obtain an advance;
  - (2) after the time the extension of credit is established, no transaction fee is charged or collected solely in connection with any debit or advance; and
  - (3) the lender or holder may not unilaterally amend the extension of credit.

Compare this to the 2007 amended language regarding HELOCs, which provides in subsection (t) that “(3) the owner does not use a credit card, debit card, [~~preprinted solicitation check,~~] or similar device, or preprinted check unsolicited by the borrower, to obtain an advance.” Although HELOC language was amended, subsection (v) in regard to reverse mortgages was not amended.

The Department of Housing and Urban Development ("HUD") has developed a product, the Home Equity Conversion Mortgage (or "HECM"). HUD issued Mortgagee Letter No. 00-9 (March 8, 2000) in which it announced, subject to instructions and modifications to certain of the model loan document forms set out in the letter, FHA would immediately begin insuring reverse mortgages under its HECM program in Texas.

HECMs are designed and insured by FHA. The purposes of the HECM Insurance program are set out in § 255(a) of the National Housing Act, Pub. L. 73-479, 68 Stat. 1246, 12 U.S.C. § 1715z-20.

The basic payment options are:

1. The tenure payment option--equal monthly payments are made by the mortgagee to the mortgagor as long as the property is the principal residence of the mortgagor;
2. The term payment option--equal monthly payments are made by the mortgagee to a mortgagor for a fixed term of months chosen by the mortgagor;
3. The line of credit payment option; or
4. A combination of the same.

24 C.F.R. § 206.17(a) (2007). Available amounts are capped by FHA loan limits. HECMs are intended for use with an existing home.

Fannie Mae has developed a reverse mortgage product, the “Home Keeper®.” Home Keeper was created to serve additional consumers whose needs cannot be met adequately by HECMs. Specifically, it is intended to provide more funds for properties with values higher than the FHA limits, as well as to make reverse mortgages more accessible to owners of condominium units. Like HECMs, the Home Keeper is also utilized with an existing home.

The HUD website has more information about reverse mortgages and the HECM program. A link follows: [www.hud.gov/buying/rvrsmort.cfm](http://www.hud.gov/buying/rvrsmort.cfm). Fannie Mae has information on its website ([www.fanniemae.com](http://www.fanniemae.com)). Also attached to this paper is the HUD Mortgage Letter 2006-06 (March 17, 2006) (Appendix F) and Fannie Mae Reverse Mortgage Lender Letter 2006-2 (February 23, 2006)(Appendix G).

APPENDIX A

Texas Constitution, Article XVI, Section 50  
[2007 AMENDMENTS REDLINED]

- (a) **The homestead of a family, or of a single adult person shall be, and is hereby protected from forced sale, for the payment of all debts except for:**
- (1) the purchase money thereof, or a part of such purchase money;
  - (2) the taxes due thereon;
  - (3) an owelty of partition imposed against the entirety of the property by a court order or by a written agreement of the parties to the partition, including a debt of one spouse in favor of the other spouse resulting from a division or an award of a family homestead in a divorce proceeding;
  - (4) the refinance of a lien against a homestead, including a federal tax lien resulting from the tax debt of both spouses, if the homestead is a family homestead, or from the tax debt of the owner;
  - (5) work and material used in constructing new improvements thereon, if contracted for in writing, or work and material used to repair or renovate existing improvements thereon if:
    - (A) the work and material are contracted for in writing, with the consent of both spouses, in the case of a family homestead, given in the same manner as is required in making a sale and conveyance of the homestead;
    - (B) the contract for the work and material is not executed by the owner or the owner's spouse before the fifth day after the owner makes written application for any extension of credit for the work and material, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing;
    - (C) the contract for the work and material expressly provides that the owner may rescind the contract without penalty or charge within three days after the execution of the contract by all parties, unless the work and material are necessary to complete immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing; and
    - (D) the contract for the work and material is executed by the owner and the owner's spouse only at the office of a third-party lender making an extension of credit for the work and material, an attorney at law, or a title company;

- (6) an extension of credit that:
- (A) is secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse;
  - (B) is of a principal amount that when added to the aggregate total of the outstanding principal balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made;
  - (C) is without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud;
  - (D) is secured by a lien that may be foreclosed upon only by a court order;
  - (E) does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit;
  - (F) is not a form of open-end account that may be debited from time to time or under which credit may be extended from time to time unless the open-end account is a home equity line of credit;
  - (G) is payable in advance without penalty or other charge;
  - (H) is not secured by any additional real or personal property other than the homestead;
  - (I) **is not secured by homestead property that on the date of closing is designated for agricultural use as provided by statutes governing property tax, unless such homestead property is used primarily for the production of milk;**
  - (J) may not be accelerated because of a decrease in the market value of the homestead or because of the owner's default under other indebtedness not secured by a prior valid encumbrance against the homestead;
  - (K) is the only debt secured by the homestead at the time the extension of credit is made unless the other debt was made for a purpose described by Subsections (a)(1)-(a)(5) or Subsection (a)(8) of this section;

**(L) is scheduled to be repaid:**

- (i) in substantially equal successive periodic installments, not more often than every 14 days and not less often than monthly, beginning no later than two months from the date the extension of credit is made, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment; or**
- (ii) if the extension of credit is a home equity line of credit, in periodic payments described under Subsection (t)(8) of this section;**

**(M) is closed not before:**

- (i) the 12th day after the later of the date that the owner of the homestead submits a loan [an] application to the lender for the extension of credit or the date that the lender provides the owner a copy of the notice prescribed by Subsection (g) of this section;**
- (ii) one business day after the date that the owner of the homestead receives a copy of the loan application if not previously provided and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing; and**
- (iii) the first anniversary of the closing date of any other extension of credit described by Subsection (a)(6) of this section secured by the same homestead property, except a refinance described by Paragraph (Q)(x)(f) of this subdivision, unless the owner on oath requests an earlier closing due to a state of emergency that:**

**(a) has been declared by the president of the United States or the governor as provided by law; and**

**(b) applies to the area where the homestead is located;**

**(N) is closed only at the office of the lender, an attorney at law, or a title company;**

**(O) permits a lender to contract for and receive any fixed or variable rate of interest authorized under statute;**

- (P) is made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area:**
- (i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States;**
  - (ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;**
  - (iii) a person licensed to make regulated loans, as provided by statute of this state;**
  - (iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase;**
  - (v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity; or**
  - (vi) a person regulated by this state as a mortgage broker; and**
- (Q) is made on the condition that:**
- (i) the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender;**
  - (ii) the owner of the homestead not assign wages as security for the extension of credit;**
  - (iii) the owner of the homestead not sign any instrument in which blanks relating to substantive terms of agreement are left to be filled in;**
  - (iv) the owner of the homestead not sign a confession of judgment or power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding;**
  - (v) [~~the lender,~~] at the time the extension of credit is made, [~~provide~~] the owner of the homestead shall receive a copy of the final loan application and all executed documents signed by the owner at closing related to the extension of credit;**

- (vi) the security instruments securing the extension of credit contain a disclosure that the extension of credit is the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;**
- (vii) within a reasonable time after termination and full payment of the extension of credit, the lender cancel and return the promissory note to the owner of the homestead and give the owner, in recordable form, a release of the lien securing the extension of credit or a copy of an endorsement and assignment of the lien to a lender that is refinancing the extension of credit;**
- (viii) the owner of the homestead and any spouse of the owner may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge;**
- (ix) the owner of the homestead and the lender sign a written acknowledgment as to the fair market value of the homestead property on the date the extension of credit is made;**
- (x) except as provided by Subparagraph (xi) of this paragraph, the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit and fails to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by:
  - (a) paying to the owner an amount equal to any overcharge paid by the owner under or related to the extension of credit if the owner has paid an amount that exceeds an amount stated in the applicable Paragraph (E), (G), or (O) of this subdivision;**
  - (b) sending the owner a written acknowledgement that the lien is valid only in the amount that the extension of credit does not exceed the percentage described by Paragraph (B) of this subdivision, if applicable, or is not secured by property described under Paragraph (H) or (I) of this subdivision, if applicable;**
  - (c) sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by this section to a permitted amount, percentage, term, or other provision and adjusting the account of the borrower to ensure that the borrower is not required to****

pay more than an amount permitted by this section and is not subject to any other term or provision prohibited by this section;

(d) **delivering the required documents to the borrower if the lender fails to comply with Subparagraph (v) of this paragraph or obtaining the appropriate signatures if the lender fails to comply with Subparagraph (ix) of this paragraph;**

(e) **sending the owner a written acknowledgement, if the failure to comply is prohibited by Paragraph (K) of this subdivision, that the accrual of interest and all of the owner's obligations under the extension of credit are abated while any prior lien prohibited under Paragraph (K) remains secured by the homestead; or**

(f) **if the failure to comply cannot be cured under Subparagraphs (x)(a)-(e) of this paragraph, curing the failure to comply by a refund or credit to the owner of \$1,000 and offering the owner the right to refinance the extension of credit with the lender or holder for the remaining term of the loan at no cost to the owner on the same terms, including interest, as the original extension of credit with any modifications necessary to comply with this section or on terms on which the owner and the lender or holder otherwise agree that comply with this section; and**

(xi) **the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the extension of credit is made by a person other than a person described under Paragraph (P) of this subdivision or if the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents;**

(7) **a reverse mortgage; or**

(8) the conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property, including the refinance of the purchase price of the manufactured home, the cost of installing the manufactured home on the real property, and the refinance of the purchase price of the real property.

- (b) An owner or claimant of the property claimed as homestead may not sell or abandon the homestead without the consent of each owner and the spouse of each owner, given in such manner as may be prescribed by law.
- (c) No mortgage, trust deed, or other lien on the homestead shall ever be valid unless it secures a debt described by this section, whether such mortgage, trust deed, or other lien, shall have been created by the owner alone, or together with his or her spouse, in case the owner is married. All pretended sales of the homestead involving any condition of defeasance shall be void.
- (d) A purchaser or lender for value without actual knowledge may conclusively rely on an affidavit that designates other property as the homestead of the affiant and that states that the property to be conveyed or encumbered is not the homestead of the affiant.
- (e) A refinance of debt secured by a homestead and described by any subsection under Subsections (a)(1)--(a)(5) that includes the advance of additional funds may not be secured by a valid lien against the homestead unless:
  - (1) the refinance of the debt is an extension of credit described by Subsection (a)(6) of this section; or
  - (2) the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for a purpose described by Subsection (a)(2), (a)(3), or (a)(5) of this section.
- (f) A refinance of debt secured by the homestead, any portion of which is an extension of credit described by Subsection (a)(6) of this section, may not be secured by a valid lien against the homestead unless the refinance of the debt is an extension of credit described by Subsection (a)(6) or (a)(7) of this section.
- (g) An extension of credit described by Subsection (a)(6) of this section may be secured by a valid lien against homestead property if the extension of credit is not closed before the 12th day after the lender provides the owner with the following written notice on a separate instrument:

"NOTICE CONCERNING EXTENSIONS OF CREDIT DEFINED BY SECTION 50(a)(6), ARTICLE XVI, TEXAS CONSTITUTION:

"SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION ALLOWS CERTAIN LOANS TO BE SECURED AGAINST THE EQUITY IN YOUR HOME. SUCH LOANS ARE COMMONLY KNOWN AS EQUITY LOANS. IF YOU DO NOT REPAY THE LOAN OR IF YOU FAIL TO MEET THE TERMS OF THE LOAN, THE LENDER MAY FORECLOSE AND SELL YOUR HOME. THE CONSTITUTION PROVIDES THAT:

"(A) THE LOAN MUST BE VOLUNTARILY CREATED WITH THE CONSENT OF EACH OWNER OF YOUR HOME AND EACH OWNER'S SPOUSE;

"(B) THE PRINCIPAL LOAN AMOUNT AT THE TIME THE LOAN IS MADE MUST NOT EXCEED AN AMOUNT THAT, WHEN ADDED TO THE PRINCIPAL

BALANCES

OF ALL OTHER LIENS AGAINST YOUR HOME, IS MORE THAN 80 PERCENT OF THE

FAIR MARKET VALUE OF YOUR HOME;

"(C) THE LOAN MUST BE WITHOUT RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE UNLESS YOU OR YOUR SPOUSE

OBTAINED THIS EXTENSION OF CREDIT BY ACTUAL FRAUD;

"(D) THE LIEN SECURING THE LOAN MAY BE FORECLOSED UPON ONLY WITH A COURT ORDER;

"(E) FEES AND CHARGES TO MAKE THE LOAN MAY NOT EXCEED 3 PERCENT OF THE LOAN AMOUNT;

"(F) THE LOAN MAY NOT BE AN OPEN-END ACCOUNT THAT MAY BE DEBITED FROM TIME TO TIME OR UNDER WHICH CREDIT MAY BE EXTENDED FROM

TIME TO TIME UNLESS IT IS A HOME EQUITY LINE OF CREDIT;

"(G) YOU MAY PREPAY THE LOAN WITHOUT PENALTY OR CHARGE;

"(H) NO ADDITIONAL COLLATERAL MAY BE SECURITY FOR THE LOAN;

"(I) THE LOAN MAY NOT BE SECURED BY [~~AGRICULTURAL~~]

HOMESTEAD

PROPERTY THAT IS DESIGNATED FOR AGRICULTURAL USE AS OF THE DATE OF

CLOSING, UNLESS THE AGRICULTURAL HOMESTEAD PROPERTY IS USED PRIMARILY FOR THE PRODUCTION OF MILK;

"(J) YOU ARE NOT REQUIRED TO REPAY THE LOAN EARLIER THAN AGREED SOLELY BECAUSE THE FAIR MARKET VALUE OF YOUR HOME

DECREASES

OR BECAUSE YOU DEFAULT ON ANOTHER LOAN THAT IS NOT SECURED BY YOUR

HOME;

"(K) ONLY ONE LOAN DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MAY BE SECURED WITH YOUR HOME

AT ANY

GIVEN TIME;

"(L) THE LOAN MUST BE SCHEDULED TO BE REPAYED IN PAYMENTS THAT EQUAL OR EXCEED THE AMOUNT OF ACCRUED INTEREST FOR EACH

PAYMENT

PERIOD;

"(M) THE LOAN MAY NOT CLOSE BEFORE 12 DAYS AFTER YOU SUBMIT

A LOAN [~~WRITTEN~~] APPLICATION TO THE LENDER OR BEFORE 12 DAYS AFTER YOU

RECEIVE THIS NOTICE, WHICHEVER DATE IS LATER; AND MAY NOT WITHOUT

YOUR CONSENT CLOSE BEFORE ONE BUSINESS DAY AFTER THE DATE ON WHICH

YOU RECEIVE A COPY OF YOUR LOAN APPLICATION IF NOT PREVIOUSLY PROVIDED AND A FINAL ITEMIZED DISCLOSURE OF THE ACTUAL FEES, POINTS, INTEREST, COSTS, AND CHARGES THAT WILL BE CHARGED AT CLOSING; AND IF YOUR HOME WAS SECURITY FOR THE SAME TYPE OF  
LOAN  
WITHIN THE PAST YEAR, A NEW LOAN SECURED BY THE SAME PROPERTY  
MAY  
NOT CLOSE BEFORE ONE YEAR HAS PASSED FROM THE CLOSING DATE OF  
THE  
OTHER LOAN, UNLESS ON OATH YOU REQUEST AN EARLIER CLOSING DUE  
TO A

DECLARED STATE OF EMERGENCY;

"(N) THE LOAN MAY CLOSE ONLY AT THE OFFICE OF THE LENDER, TITLE COMPANY, OR AN ATTORNEY AT LAW;

"(O) THE LENDER MAY CHARGE ANY FIXED OR VARIABLE RATE OF INTEREST AUTHORIZED BY STATUTE;

"(P) ONLY A LAWFULLY AUTHORIZED LENDER MAY MAKE LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION;

"(Q) LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MUST:

"(1) NOT REQUIRE YOU TO APPLY THE PROCEEDS TO ANOTHER DEBT EXCEPT A DEBT THAT IS SECURED BY YOUR HOME OR OWED TO ANOTHER LENDER;

"(2) NOT REQUIRE THAT YOU ASSIGN WAGES AS SECURITY;

"(3) NOT REQUIRE THAT YOU EXECUTE INSTRUMENTS WHICH HAVE BLANKS FOR SUBSTANTIVE TERMS OF AGREEMENT LEFT TO BE FILLED IN;

"(4) NOT REQUIRE THAT YOU SIGN A CONFESSION OF JUDGMENT OR POWER OF ATTORNEY TO ANOTHER PERSON TO CONFESS JUDGMENT OR

APPEAR IN

A LEGAL PROCEEDING ON YOUR BEHALF;

"(5) PROVIDE THAT YOU RECEIVE A COPY OF YOUR FINAL LOAN APPLICATION AND ALL EXECUTED DOCUMENTS YOU SIGN AT CLOSING;

"(6) PROVIDE THAT THE SECURITY INSTRUMENTS CONTAIN A DISCLOSURE THAT THIS LOAN IS A LOAN DEFINED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION;

"(7) PROVIDE THAT WHEN THE LOAN IS PAID IN FULL, THE LENDER WILL SIGN AND GIVE YOU A RELEASE OF LIEN OR AN ASSIGNMENT OF THE LIEN, WHICHEVER IS APPROPRIATE;

"(8) PROVIDE THAT YOU MAY, WITHIN 3 DAYS AFTER CLOSING, RESCIND THE LOAN WITHOUT PENALTY OR CHARGE;

"(9) PROVIDE THAT YOU AND THE LENDER ACKNOWLEDGE THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LOAN CLOSES; AND

"(10) PROVIDE THAT THE LENDER WILL FORFEIT ALL PRINCIPAL AND INTEREST IF THE LENDER FAILS TO COMPLY WITH THE LENDER'S OBLIGATIONS UNLESS THE LENDER CURES THE FAILURE TO COMPLY AS

PROVIDED BY SECTION 50(a)(6)(Q)(x), ARTICLE XVI, OF THE TEXAS CONSTITUTION; AND

"(R) IF THE LOAN IS A HOME EQUITY LINE OF CREDIT:

"(1) YOU MAY REQUEST ADVANCES, REPAY MONEY, AND REBORROW MONEY UNDER THE LINE OF CREDIT;

"(2) EACH ADVANCE UNDER THE LINE OF CREDIT MUST BE IN AN AMOUNT OF AT LEAST \$4,000;

"(3) YOU MAY NOT USE A CREDIT CARD, DEBIT CARD, [~~SOLICITATION CHECK;~~] OR SIMILAR DEVICE, OR PREPRINTED CHECK THAT

YOU DID NOT SOLICIT, TO OBTAIN ADVANCES UNDER THE LINE OF CREDIT;

"(4) ANY FEES THE LENDER CHARGES MAY BE CHARGED AND COLLECTED ONLY AT THE TIME THE LINE OF CREDIT IS ESTABLISHED AND

THE

LENDER MAY NOT CHARGE A FEE IN CONNECTION WITH ANY ADVANCE;

WHEN

"(5) THE MAXIMUM PRINCIPAL AMOUNT THAT MAY BE EXTENDED,

ADDED TO ALL OTHER DEBTS SECURED BY YOUR HOME, MAY NOT EXCEED 80

PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LINE OF

CREDIT IS ESTABLISHED;

"(6) IF THE PRINCIPAL BALANCE UNDER THE LINE OF CREDIT AT ANY TIME EXCEEDS 50 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME,

AS DETERMINED ON THE DATE THE LINE OF CREDIT IS ESTABLISHED, YOU MAY

NOT CONTINUE TO REQUEST ADVANCES UNDER THE LINE OF CREDIT UNTIL THE

BALANCE IS LESS THAN 50 PERCENT OF THE FAIR MARKET VALUE; AND

"(7) THE LENDER MAY NOT UNILATERALLY AMEND THE TERMS OF THE

LINE OF CREDIT.

"THIS NOTICE IS ONLY A SUMMARY OF YOUR RIGHTS UNDER THE TEXAS

CONSTITUTION. YOUR RIGHTS ARE GOVERNED BY SECTION 50, ARTICLE XVI,

OF THE TEXAS CONSTITUTION, AND NOT BY THIS NOTICE."

If the discussions with the borrower are conducted primarily in a language other than English, the lender shall, before closing, provide an additional copy of the notice translated into the written language in which the discussions were conducted.

(t) A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

(1) the owner requests advances, repays money, and

reborrows money;

(2) any single debit or advance is not less than \$4,000;

(3) the owner does not use a credit card, debit card, ~~[preprinted solicitation check,]~~ or similar device, or preprinted check unsolicited by the borrower, to obtain an advance;

(4) any fees described by Subsection (a)(6)(E) of this section are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance;

(5) the maximum principal amount that may be extended under the account, when added to the aggregate total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, does not exceed an amount described under Subsection (a)(6)(B) of this section;

(6) no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established;

(7) the lender or holder may not unilaterally amend the extension of credit; and

(8) repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and:

(A) during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and

(B) after the period during which the owner may request advances, installments are substantially equal.

If the discussions with the borrower are conducted primarily in a language other than English, the lender shall, before closing, provide an additional copy of the notice translated into the written language in which the discussions were conducted.

(h) A lender or assignee for value may conclusively rely on the written acknowledgment as to the fair market value of the homestead property made in accordance with Subsection (a)(6)(Q)(ix) of this section if:

(1) the value acknowledged to is the value estimate in an appraisal or evaluation prepared in accordance with a state or federal requirement applicable to an extension of credit under Subsection (a)(6); and

(2) the lender or assignee does not have actual knowledge at the time of the payment of value or advance of funds by the lender or assignee that the fair market value stated in the written acknowledgment was incorrect.

(i) This subsection shall not affect or impair any right of the borrower to recover damages from the lender or assignee under applicable law for wrongful foreclosure. A purchaser for value without actual knowledge may conclusively presume that a lien securing an extension of credit described by Subsection (a)(6) of this section was a valid lien securing the extension of credit with homestead property if:

(1) the security instruments securing the extension of credit contain a disclosure that the extension of credit secured by the lien was the type of credit defined by Section 50(a)(6), Article XVI, Texas Constitution;

(2) the purchaser acquires the title to the property pursuant to or after the foreclosure of the voluntary lien; and

(3) the purchaser is not the lender or assignee under the extension of credit.

(j) Subsection (a)(6) and Subsections (e)-(i) of this section are not severable, and none of those provisions would have been enacted without the others. If any of those provisions are held to be preempted by the laws of the United States, all of those provisions are invalid. This subsection shall not apply to any lien or extension of credit made after January 1, 1998, and before the date any provision under Subsection (a)(6) or Subsections (e)-(i) is held to be preempted.

(k) "Reverse mortgage" means an extension of credit:

(1) that is secured by a voluntary lien on homestead property created by a written agreement with the consent of each owner and each owner's spouse;

(2) that is made to a person who is or whose spouse is 62 years or older;

(3) that is made without recourse for personal liability against each owner and the spouse of each owner;

(4) under which advances are provided to a borrower based on the equity in a borrower's homestead;

(5) that does not permit the lender to reduce the amount or number of advances because of an adjustment in the interest rate if periodic advances are to be made;

(6) that requires no payment of principal or interest until:

(A) all borrowers have died;

(B) the homestead property securing the loan is sold or otherwise transferred;

(C) all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval from the lender; or

(D) the borrower:

(i) defaults on an obligation specified in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property;

(ii) commits actual fraud in connection with the loan; or

(iii) fails to maintain the priority of the lender's lien on the homestead property, after the lender gives notice to the borrower, by promptly discharging any lien that has priority or may obtain priority over the lender's lien within 10 days after the date the borrower receives the notice, unless the borrower:

(a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to the lender;

(b) contests in good faith the lien by, or defends against enforcement of the lien in, legal proceedings so as to prevent the enforcement of the lien or forfeiture of any part of the homestead property; or

(c) secures from the holder of the lien an agreement satisfactory to the lender subordinating the lien to all amounts secured by the lender's lien on the homestead property;

(7) that provides that if the lender fails to make loan advances as required in the loan documents and if the lender fails to cure the default as required in the loan documents after notice from the borrower, the lender forfeits all principal and interest of the reverse mortgage, provided, however, that this subdivision does not apply when a governmental agency or instrumentality takes an assignment of the loan in order to cure the default;

(8) that is not made unless the owner of the homestead attests in writing that the owner received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives;

(9) that requires the lender, at the time the loan is made, to disclose to the borrower by written notice the specific provisions contained in Subdivision (6) of this subsection under which the borrower is required to repay the loan;

(10) that does not permit the lender to commence foreclosure until the lender gives notice to the borrower, in the manner provided for a notice by mail related to the foreclosure of liens under Subsection (a)(6) of this section, that a ground for foreclosure exists and gives the borrower at least 30 days, or at least 20 days in the event of a default under Subdivision (6)(D)(iii) of this subsection, to:

(A) remedy the condition creating the ground for foreclosure;

(B) pay the debt secured by the homestead property from proceeds of the sale of the homestead property by the borrower or from any other sources; or

(C) convey the homestead property to the lender by a deed in lieu of foreclosure; and

(11) that is secured by a lien that may be foreclosed upon only by a court order, if the foreclosure is for a ground other than a ground stated by Subdivision (6)(A) or (B) of this subsection.

(l) Advances made under a reverse mortgage and interest on those advances have priority over a lien filed for record in the real property records in the county where the homestead property is located after the reverse mortgage is filed for record in the real property records of that county.

(m) A reverse mortgage may provide for an interest rate that is fixed or adjustable and may also provide for interest that is contingent on appreciation in the fair market value of the homestead property. Although payment of principal or interest shall not be required under a reverse mortgage until the entire loan becomes due and payable, interest may accrue and be compounded during the term of the loan as provided by the reverse mortgage loan agreement.

(n) A reverse mortgage that is secured by a valid lien against homestead property may be made or acquired without regard to the following provisions of any other law of this state:

(1) a limitation on the purpose and use of future advances or other mortgage proceeds;

(2) a limitation on future advances to a term of years or a limitation on the term of open-end account advances;

(3) a limitation on the term during which future advances take priority over intervening advances;

(4) a requirement that a maximum loan amount be stated in the reverse mortgage loan documents;

(5) a prohibition on balloon payments;

(6) a prohibition on compound interest and interest on interest;

(7) a prohibition on contracting for, charging, or receiving any rate of interest authorized by any law of this state authorizing a lender to contract for a rate of interest; and

(8) a requirement that a percentage of the reverse mortgage proceeds be advanced before the assignment of the reverse mortgage.

(o) For the purposes of determining eligibility under any statute relating to payments, allowances, benefits, or services provided on a means-tested basis by this state, including supplemental security income, low-income energy assistance, property tax relief, medical assistance, and general assistance:

(1) reverse mortgage loan advances made to a borrower are considered proceeds from a loan and not income; and

(2) undisbursed funds under a reverse mortgage loan are considered equity in a borrower's home and not proceeds from a loan.

(p) The advances made on a reverse mortgage loan under which more than one advance is made must be made according to the terms established by the loan documents by one or more of the following methods:

(1) an initial advance at any time and future advances at regular intervals;

(2) an initial advance at any time and future advances at regular intervals in which the amounts advanced may be reduced, for one or more advances, at the request of the borrower;

(3) an initial advance at any time and future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached;

(4) an initial advance at any time, future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance is repaid; or

(5) at any time by the lender, on behalf of the borrower, if the borrower fails to timely pay any of the following that the borrower is obligated to pay under the loan documents to the extent necessary to protect the lender's interest in or the value of the homestead property:

(A) taxes;

(B) insurance;

(C) costs of repairs or maintenance performed by a person or company that is not an employee of the lender or a person or company that directly or indirectly controls, is controlled by, or is under common control with the lender;

(D) assessments levied against the homestead property; and

(E) any lien that has, or may obtain, priority over the lender's lien as it is established in the loan documents.

(q) To the extent that any statutes of this state, including without limitation, Section 41.001 of the Texas Property Code, purport to limit encumbrances that may properly be fixed on homestead property in a manner that does not permit encumbrances for extensions of credit described in Subsection (a)(6) or (a)(7) of this section, the same shall be superseded to the extent that such encumbrances shall be permitted to be fixed upon homestead property in the manner provided for by this amendment.

(r) The supreme court shall promulgate rules of civil procedure for expedited foreclosure proceedings related to the foreclosure of liens under Subsection (a)(6) of this section and to foreclosure of a reverse mortgage lien that requires a court order.

(s) The Finance Commission of Texas shall appoint a director to conduct research on the availability, quality, and prices of financial services and research the practices of business entities in the state that provide financial services under this section. The director shall collect information and produce reports on lending activity of those making loans under this section. The director shall report his or her findings to the legislature not later than December 1 of each year.

(t) A home equity line of credit is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which:

(1) the owner requests advances, repays money, and reborrows money;

(2) any single debit or advance is not less than \$ 4,000;

(3) the owner does not use a credit card, debit card, or similar device, or preprinted check unsolicited by the borrower, to obtain an advance;

(4) any fees described by Subsection (a)(6)(E) of this section are charged and collected only at the time the extension of credit is established and no fee is charged or collected in connection with any debit or advance;

(5) the maximum principal amount that may be extended under the account, when added to the aggregate total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, does not exceed an amount described under Subsection (a)(6)(B) of this section;

(6) no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the homestead as determined on the date the account is established;

(7) the lender or holder may not unilaterally amend the extension of credit; and

(8) repayment is to be made in regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established, and:

(A) during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and

(B) after the period during which the owner may request advances, installments are substantially equal.

(u) The legislature may by statute delegate one or more state agencies the power to interpret Subsections (a)(5)--(a)(7), (e)--(p), and (t), of this section. An act or omission does not violate a provision included in those subsections if the act or omission conforms to an interpretation of the provision that is:

(1) in effect at the time of the act or omission; and

(2) made by a state agency to which the power of interpretation is delegated as provided by this subsection or by an appellate court of this state or the United States.

(v) A reverse mortgage must provide that:

(1) the owner does not use a credit card, debit card, preprinted solicitation check, or similar device to obtain an advance;

(2) after the time the extension of credit is established, no transaction fee is charged or collected solely in connection with any debit or advance; and

(3) the lender or holder may not unilaterally amend the extension of credit.

**HISTORY:** Amendment proposed by Acts 1995, 74th Leg., S.J.R. No. 46, approved by electorate (Prop. 4) at the November 7, 1995 election; amendment proposed by Acts 1997, 75th Leg., H.J.R. No. 31, approved by electorate at the November 4, 1997 election; amendment proposed by Acts 1999, 76th Leg., S.J.R. No. 12, approved by electorate (Prop. 2) at the November 2, 1999 constitutional amendment election; amendment proposed by Acts 2001, 77th Leg., H.J.R. No. 75, approved by electorate at the November 6, 2001 general election; amendment proposed by Acts 2003, 78th Leg., H.J.R. No. 23 and S.J.R. No. 42, approved by electorate at the September 13, 2003 election; amendment proposed by Acts 2005, 79th Leg., S.J.R. No. 7, approved by the electorate (Prop. 7) at the November 8, 2005 election; amendment proposed by Acts 2007, 80th Leg., H.J.R. No. 72, approved by the electorate (Prop. 8) at the November 6, 2007 election.

**NOTES:**

1997 Note: The amendment to Section 50, Article XVI, of this constitution takes effect for the tax year beginning January 1, 1998. 1997 75th Leg., H.J.R. No. 31, § 3.

Editor's Notes. -- Acts 2007, 80th Leg., H.J.R. No. 72, § 2 provides: "This proposed constitutional amendment shall be submitted to the voters at an election to be held November 6, 2007. The ballot shall be printed to permit voting for or against the proposition: 'The constitutional amendment to clarify certain provisions relating to the making of a home equity loan and use of home equity loan proceeds.'" The proposed amendment was approved by the electorate at the November 6, 2007 election.

2005 amendment, in (p), added "an initial advance at any time and future advances" in (1) and (2), added (3) and (4), and redesignated former (3) as (5); and added (v).

2007 amendment, in (a)(6), added "that on the date of closing is" in (I), substituted "a loan application" for "an application" in (M)(i), added "a copy of the loan application if not previously provided and" in (M)(ii), added "unless the owner on oath requests an earlier closing due to a state emergency that:", added (M)(iii)(a) and (M)(iii)(b), added "relating to substantive terms of agreement" in (Q)(iii), substituted the present provisions of (Q)(v) for the former provisions, which read: "the lender, at the time the extension of credit is made, provide the owner of the homestead a copy of all documents signed by the owner related to the extension of credit;" in (g), deleted "AGRICULTURAL" before "HOMESTEAD PROPERTY" and added "THAT IS DESIGNATED FOR AGRICULTURAL USE AS OF THE DATE OF CLOSING" in (I), in (M), substituted "LOAN APPLICATION" for "WRITTEN APPLICATION," added "AND MAY NOT WITHOUT YOUR CONSENT CLOSE BEFORE ONE BUSINESS DAY AFTER THE DATE ON WHICH YOU RECEIVE A COPY OF YOUR LOAN APPLICATION

IF NOT PREVIOUSLY PROVIDED AND A FINAL ITEMIZED DISCLOSURE OF THE ACTUAL FEES, POINTS, INTEREST, COSTS, AND CHARGES THAT WILL BE CHARGED AT CLOSING;" and "UNLESS ON OATH YOU REQUEST AN EARLIER CLOSING DUE TO A DECLARED STATE OF EMERGENCY" at the end; in (Q), added "FOR SUBSTANTIVE TERMS OF AGREEMENT" in (3), and added "YOUR FINAL LOAN APPLICATION" and "EXECUTED" in (5); in (R)(3), deleted "SOLICITATION CHECK," after "DEBIT CARD" and added "OR PREPRINTED CHECK THAT YOU DID NOT SOLICIT"; and in (t)(3), deleted "preprinted solicitation check," after "debit card" and added "or preprinted check unsolicited by the borrower."

**APPENDIX B**  
**TEXAS ADMINISTRATION CODE**  
**7 TEX. ADMIN. CODE (2007)**

**§ 153.5. Three percent fee limitation: Section 50(a)(6)(E)**

An equity loan must not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit.

- (1) **Optional Charges.** Charges paid by an owner or an owner's spouse at their sole discretion are not fees subject to the three percent fee limitation. Charges that are not imposed or required by the lender, but that are optional, are not fees subject to the three percent limitation. The use of the word "require" in Section 50(a)(6)(E) means that optional charges are not fees subject to the three percent limitation.
- (2) **Optional Insurance.** Insurance coverage premiums paid by an owner or an owner's spouse that are at their sole discretion are not fees subject to the three percent limitation. Examples of these charges may include credit life and credit accident and health insurance that are voluntarily purchased by the owner or the owner's spouse.
- (3) **Charges that are Interest.** Charges an owner or an owner's spouse is required to pay that constitute interest under the law, for example per diem interest and **points**, are not fees subject to the three percent limitation.
- (4) **Charges that are not Interest.** Charges an owner or an owner's spouse is required to pay that are not interest are fees subject to the three percent limitation.
- (5) **Charges Absorbed by Lender.** Charges a lender absorbs, and does not charge an owner or an owner's spouse that the owner or owner's spouse might otherwise be required to pay are unrestricted and not fees subject to the three percent limitation.
- (6) **Charges to Originate.** Charges an owner or an owner's spouse is required to pay to originate an equity loan that are not interest are fees subject to the three percent limitation.
- (7) **Charges Paid to Third Parties.** Charges an owner or an owner's spouse is required to pay to third parties for separate and additional consideration for activities relating to originating a loan are fees subject to the three percent limitation.

Charges those third parties absorb, and do not charge an owner or an owner's spouse that the owner or owner's spouse might otherwise be required to pay are unrestricted and not fees subject to the three percent limitation. Examples of these charges include attorneys' fees for document preparation and mortgage brokers' fees to the extent authorized by applicable law.

- (8) Charges to Evaluate. Charges an owner or an owner's spouse is required to pay to evaluate the credit decision for an equity loan, that are not interest, are fees subject to the three percent limitation. Examples of these charges include fees collected to cover the expenses of a credit report, survey, flood zone determination, tax certificate, title report, inspection, or appraisal.
- (9) Charges to Maintain. Charges paid by an owner or an owner's spouse at the inception of an equity loan to maintain the loan that are not interest are fees subject to the three percent limitation. Charges that are not interest that an owner pays at the inception of an equity loan to maintain the equity loan, or that are customarily paid at the inception of an equity loan to maintain the equity loan, but are deferred for later payment after closing, are fees subject to the three percent limitation.
- (10) Charges to Record. Charges an owner or an owner's spouse is required to pay for the purpose of recording equity loan documents in the official public record by public officials are fees subject to the three percent limitation.
- (11) Charges to Insure an Equity Loan. Premiums an owner or an owner's spouse is required to pay to insure an equity loan are fees subject to the three percent limitation. Examples of these charges include title insurance and mortgage insurance protection.
- (12) Charges to Service. Charges paid by an owner or an owner's spouse at the inception of an equity loan for a party to service the loan that are not interest are fees subject to the three percent limitation. Charges that are not interest that an owner pays at the inception of an equity loan to service the equity loan, or that are customarily paid at the inception of an equity loan to service the equity loan, but are deferred for later payment after closing, are fees subject to the three percent limitation.
- (13) Secondary Mortgage Loans. A lender making an equity loan that is a secondary mortgage loan under Chapter 342 of the Texas Finance Code may charge only those fees permitted in TEX. FIN. CODE, §§ 342.307, 342.308, and 342.502. A lender must comply with the provisions of Chapter 342 of the Texas Finance Code and the constitutional restrictions on fees in connection with a secondary mortgage loan made under Chapter 342 of the Texas Finance Code.

- (14) Escrow Funds. A lender may provide escrow services for an equity loan. Because funds tendered by an owner or an owner's spouse into an escrow account remain the property of the owner or the owner's spouse those funds are not fees subject to the three percent limitation. Examples of escrow funds include account funds collected to pay taxes, insurance premiums, maintenance fees, or homeowner's association assessments. A lender must not contract for a right of offset against escrow funds pursuant to Section 50(a)(6)(H).
- (15) Subsequent Events. The three percent limitation pertains to fees paid or contracted for by an owner or owner's spouse at the inception or at the closing of an equity loan. On the date the equity loan is closed an owner or an owner's spouse may agree to perform certain promises during the term of the equity loan. Failure to perform an obligation of an equity loan may trigger the assessment of costs to the owner or owner's spouse. The assessment of costs is a subsequent event triggered by the failure of the owner's or owner's spouse to perform under the equity loan agreement and is not a fee subject to the three percent limitation. Examples of subsequent event costs include contractually permitted charges for force-placed homeowner's insurance costs, returned check fees, debt collection costs, late fees, and costs associated with foreclosure.
- (16) Property Insurance Premiums. Premiums an owner or an owner's spouse is required to pay to purchase homeowner's insurance coverage are not fees subject to the three percent limitation. Examples of property insurance premiums include fire and extended coverage insurance and flood insurance. Failure to maintain this insurance is generally a default provision of the equity loan agreement and not a condition of the extension of credit. The lender may collect and escrow premiums for this insurance and include the premium in the periodic payment amount or principal amount. If the lender sells insurance to the owner, the lender must comply with applicable law concerning the sale of insurance in connection with a mortgage loan.

SOURCE: The provisions of this § 153.5 adopted to be effective January 8, 2004, 29 TexReg 84

**§ 153.12. Closing Date: Section 50(a)(6)(M)(i)**

An equity loan may not be closed before the 12th calendar day after the later of the date that the owner submits an application for the loan to the lender or the date that the lender provides the owner a copy of the required consumer disclosure. For purposes of determining the earliest permitted closing date, the next succeeding calendar day after the date the lender provides the owner a copy of the required consumer disclosure is the first day of the 12-day waiting period. The equity loan may be closed at any time on or after the 12th calendar day after the date the consumer disclosure is provided to the owner.

- (1) Submission of a loan application to an agent acting on behalf of the lender is submission to the lender.
- (2) A loan application may be given orally or electronically.

SOURCE: The provisions of this § 153.12 adopted to be effective January 8, 2004, 29 TexReg 84

### **§ 153.13. Preclosing Disclosures: Section 50(a)(6)(M)(ii)**

An equity loan may not be closed before one business day after the date that the owner of the homestead receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. If a bona fide emergency or another good cause exists and the lender obtains the written consent of the owner, the lender may provide the documentation to the owner or the lender may modify previously provided documentation on the date of closing.

- (1) A lender may satisfy the disclosure requirement of this section by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A.
- (2) Bona fide emergency.
  - (A) An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing in the case of a bona fide emergency occurring before the date of the extension of credit. An equity loan secured by a homestead in an area designated by Federal Emergency Management Agency (FEMA) as a disaster area is an example of a bona fide emergency if the homestead was damaged during FEMA's declared incident period.
  - (B) To document a bona fide emergency modification, the lender should obtain a written statement from the owner that:
    - (i) describes the emergency;
    - (ii) specifically states that the owner consents to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing;
    - (iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and

- (iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all actual fees, points, costs, and charges one day prior to closing.
- (3) Good cause. An owner may consent to receive the preclosing disclosure or a modification of the preclosing disclosure on the date of closing if another good cause exists.
  - (A) Good cause to modify the preclosing disclosure or to receive a subsequent disclosure modifying the preclosing disclosure on the date of closing may only be established by the owner.
    - (i) The term "good cause" as used in this section means a legitimate or justifiable reason, such as financial impact or an adverse consequence.
    - (ii) At the owner's election, a good cause to modify the preclosing disclosure may be established if:
      - (I) the modification does not create a material adverse financial consequence to the owner; or
      - (II) a delay in the closing would create an adverse consequence to the owner.
    - (iii) The term "de minimis" as used in this section means a very small or insignificant amount.
  - (B) At the owner's election, a de minimis good cause standard may be presumed if:
    - (i) the total actual disclosed fees, costs, points, and charges on the date of closing do not exceed in the aggregate more than the greater of \$ 100 or 0.125 percent of the principal amount of the loan (e.g. 0.125 percent on a \$ 80,000 principal loan amount equals \$ 100) from the initial preclosing disclosure; and
    - (ii) no itemized fee, cost, point, or charge exceeds more than the greater of \$ 100 or 0.125 percent of the principal amount of the loan than the amount disclosed in the initial preclosing disclosure.

- (C) To document a good cause modification of the disclosure, the lender should obtain a written statement from the owner that:
  - (i) describes the good cause;
  - (ii) specifically states that the owner consents to receive the preclosing disclosure on the date of closing;
  - (iii) bears the signature of all of the owners entitled to receive the preclosing disclosure; and
  - (iv) affirms the owner has received notice of the owner's right to receive a final itemized disclosure containing all fees, costs, points, or charges one day prior to closing.
- (4) An equity loan may be closed at any time during normal business hours on the next business day following the calendar day on which the owner receives the preclosing disclosure or any calendar day thereafter.
- (5) The owner maintains the right of rescission under Section 50(a)(6)(Q)(viii) even if the owner exercises an emergency or good cause modification of the preclosing disclosure.

SOURCE: The provisions of this § 153.13 adopted to be effective June 29, 2006, 31 TexReg 5080; amended to be effective November 9, 2006, 31 TexReg 9022

**§ 153.14. One Year Prohibition: Section 50(a)(6)(M)(iii)**

An equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property. An equity loan may be refinanced any time after the first anniversary of the loan's closing date.

- (1) Section 50(a)(6)(M)(iii) prohibits an owner who has obtained an equity loan from:
  - (A) refinancing the equity loan before one year has elapsed since the loan's closing date; or
  - (B) obtaining a new equity loan on the same homestead property before one year has elapsed since the previous equity loan's closing date, regardless of whether the previous equity loan has been paid in full.

- (2) Section 50(a)(6)(M)(iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification is a transaction in which one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced.
  - (A) A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. An example of a modification that is not required to be in writing is the modification required under the Soldiers' and Sailors' Civil Relief Act.
  - (B) The advance of additional funds to a borrower is not permitted by modification of an equity loan.
  - (C) A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.

SOURCE: The provisions of this § 153.14 adopted to be effective January 8, 2004, 29 TexReg 84.

#### **§ 153.15. Location of Closing: Section 50(a)(6)(N)**

An equity loan may be closed only at an office of the lender, an attorney at law, or a title company. The lender is anyone authorized under Section 50(a)(6)(P) that advances funds directly to the owner or is identified as the payee on the note.

- (1) An equity loan must be closed at the permanent physical address of the office or branch office of the lender, attorney, or title company. The closing office must be a permanent physical address so that the closing occurs at an authorized physical location other than the homestead.
- (2) A lender may accept a properly executed power of attorney allowing the attorney-in-fact to execute closing documents on behalf of the owner.
- (3) A lender may receive consent required under Section 50(a)(6)(A) by mail or other delivery of the party's signature to an authorized physical location and not the homestead.

SOURCE: The provisions of this § 153.15 adopted to be effective January 8, 2004, 29 TexReg 84

### **§ 153.16. Rate of Interest: Section 50(a)(6)(O)**

A lender may contract for and receive any fixed or variable rate of interest authorized under statute.

- (1) An equity loan that provides for interest must comply with constitutional and applicable law. Interest rates on certain first mortgages are not limited on loans subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980 and the Alternative Mortgage Transaction Parity Act. Chapter 342 of the Texas Finance Code provides for a maximum rate on certain secondary mortgage loans. Chapter 124 of the Texas Finance Code and federal law provide for maximum rates on certain mortgage loans made by credit unions. These statutes operate in conjunction with Section 50(a) and other constitutional sections.
- (2) An equity loan must amortize and contribute to amortization of principal.
- (3) The lender may contract to vary the scheduled installment amount when the interest rate adjusts on a variable rate equity loan. A variable-rate loan is a mortgage in which the lender, by contract, can adjust the mortgage's interest rate after closing in accordance with an external index.
- (4) The scheduled installment amounts of a variable rate equity loan must be:
  - (A) substantially equal between each interest rate adjustment; and
  - (B) sufficient to cover at least the amount of interest scheduled to accrue between each payment date and a portion of the principal.
- (5) An equity loan agreement may contain an adjustable rate of interest that provides a maximum fixed rate of interest pursuant to a schedule of steps or tiered rates or provides a lower initial interest rate through the use of a discounted rate at the beginning of the loan.

SOURCE: The provisions of this § 153.16 adopted to be effective January 8, 2004, 29 TexReg 84.

### **§ 153.17. Authorized Lenders: Section 50(a)(6)(P)**

An equity loan must be made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area: a bank, savings and loan association, savings bank, or credit union doing business under the

laws of this state or the United States; a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans; a person licensed to make regulated loans, as provided by statute of this state; a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase; a person who is related to the homestead owner within the second degree of affinity and consanguinity; or a person regulated by this state as a mortgage broker.

- (1) An authorized lender under Chapter 341, Texas Finance Code, must meet both constitutional and statutory qualifications to make an equity loan.
- (2) A HUD-approved mortgagee is a person approved as a mortgagee by the United States government to make federally insured loans. Approved correspondents to a HUD-approved mortgagee are not authorized lenders of equity loans unless qualifying under another section of (a)(6)(P).
- (3) A non-depository lender or broker that makes, negotiates, arranges, or transacts a secondary mortgage loan that is governed by Chapter 342, Texas Finance Code, must comply with the licensing provisions of Chapter 342, Texas Finance Code.
- (4) A lender who does not meet the definition of Section 50(a)(6)(P)(i), (ii), (iv), (v), or (vi), must obtain a regulated loan license under Chapter 342 of the Texas Finance Code to meet the provisions of subsection (iii).

SOURCE: The provisions of this § 153.17 adopted to be effective January 8, 2004, 29 TexReg 84.

#### **§ 153.18. Limitation on Application of Proceeds: Section 50(a)(6)(Q)(I)**

An equity loan must be made on the condition that the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender.

- (1) The lender may not require an owner to repay a debt owed to the lender, unless it is a debt secured by the homestead. The lender may require debt secured by the homestead or debt to another lender or creditor be paid out of the proceeds of an equity loan.
- (2) An owner may apply for an equity loan for any purpose. An owner is not precluded from voluntarily using the proceeds of an equity loan to pay on a debt owed to the lender making the equity loan.

SOURCE: The provisions of this § 153.18 adopted to be effective June 29, 2006, 31 TexReg 5080.

**§ 153.84. Restrictions on Devices and Methods to Obtain a HELOC Advance: Section 50(t)(3)**

A HELOC is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which an owner is prohibited from using a credit card, debit card, preprinted solicitation check, or similar device to obtain a HELOC advance.

- (1) A lender may offer one or more non-prohibited devices or methods for use by the owner to request an advance. Permissible methods include contacting the lender directly for an advance, telephonic fund transfers, and electronic fund transfers. Examples of devices that are not prohibited similar devices include prearranged drafts, convenience checks, or written transfer instructions. Regardless of the permissible method or device used to obtain a HELOC advance, the amount of the advance must comply with:
  - (A) the advance requirements in Section 50(t)(2);
  - (B) the loan to value limits in Section 50(t)(5); and
  - (C) the debit or advance limits in Section 50(t)(6).
- (2) An owner may, but is not required to, make in-person contact with the lender to obtain a HELOC advance.
- (3) A credit card, which is a prohibited device under Section 50(t)(3), is a card that may be used for personal, family, or household use to debit an open-end account.
- (4) A preprinted solicitation check, which is a prohibited device under Section 50(t)(3), is a check that:
  - (A) is provided to an owner for the purpose of originating a HELOC or to a borrower for the purpose of soliciting additional advances on an existing HELOC;
  - (B) contains at least one preprinted key payment term, such as the amount or payee; and
  - (C) is not requested by the borrower or owner.

SOURCE: The provisions of this § 153.84 adopted to be effective March 11, 2004, 29 TexReg 2306

REGULATORY COMMENTARY  
ON EQUITY LENDING PROCEDURES



October 7, 1998

Issued by:

Office of Consumer Credit Commissioner  
Department of Banking  
Savings and Loan Department  
Credit Union Department

PREAMBLE:

The Texas Constitution has protected homesteads from forced sale for 158 years. The constitutional provisions permitted loans for the purposes of (1) purchase money; (2) taxes; (3) an owelty of partition; (4) the refinance of a lien, including tax liens; and (5) home improvements. The 75th Legislature passed House Joint Resolution 31 (HJR 31), which was adopted by the voters on November 4, 1997. Effective January 1, 1998, HJR 31 creates two additional categories of authorized liens: an equity loan and a reverse mortgage on a homestead. HJR 31 also modifies the existing provisions regarding liens on a homestead for home improvement purposes.

Section 50, Article XVI of the constitution enumerates the permissible encumbrances on a homestead. Section 50 addresses only the elements necessary to create a valid lien on a homestead. Different statutes and constitutional provisions govern the legality of credit transactions and specifically loans. Section 11, Article XVI of the constitution permits interest rates of 10% or less on credit transactions. It then states that the Legislature may by statute, classify loans and provide alternative interest rates. The Legislature did so in Title 79, Texas Civil Statutes and in Titles 3 and 4, *Texas Finance Code*. A mortgage loan's classification regarding the appropriate treatment under credit law hinges upon the lien position. A first lien mortgage loan is governed by the provisions of Subtitle I, Title 79. However, Congress in the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Alternative Mortgage Transactions Parity Act preempted state interest rate limitations on certain first lien residential mortgage loans. A secondary mortgage loan that exceeds the constitutional rate of 10% interest falls within the jurisdiction of Subtitle II, Title 79. The specific statutory provisions are found in art. 5069, Chapter 3A, Subchapter G.

Regulatory Authority

The fact that most of the provisions regarding implementation of home equity lending reside in the constitution creates a dilemma for providing interpretations of particular provisions. Inherent in an issue as complex as home equity are details that simply cannot be fully addressed within the text of the amendment. The consumer credit commissioner has had interpretation authority over the provisions of Title 79 for many years. This process works well for resolving ambiguities and providing certainties for parties entering into a credit transaction. Additionally, the Finance Commission of Texas has broad rulemaking authority over all of Title 79 to provide definition and implement the credit laws.

The state regulatory agencies with authority over authorized lenders believe it is important to follow the will of the citizenry and the Legislature and foster a workable environment for equity loans. The regulators believe it is their responsibility to provide for a reasonable implementation of home equity lending and inform the regulated community of the guidelines that will be used to enforce the provisions of HJR 31. Additionally, these policies should provide guidance to lenders and consumers concerning the regulatory views of the meaning and effect of HJR 31. The positions presented in this commentary are the opinions of the state administrative agencies responsible for regulating the entities making these loans and these views will be used to evaluate compliance with the constitutional requirements in examination and enforcement situations. However, a court may or may not defer to this interpretation in resolving a dispute between a borrower and a lender.

## SECTION 50(a)

The constitutional amendment uses the term "an extension of credit." This commentary on the resolution will use the term "equity loan" for the ease of convenience and possibly for greater comprehension. An extension of credit is the same as an equity loan for the purpose of this discussion. An equity loan has been defined and authorized under the provisions of section 50(a)(6), Article XVI of the Texas Constitution. Certain provisions refer to "the date the extension of credit is made." This phrase refers to the date that the parties become contractually obligated. The definition consists of approximately 26 elements, each of which must be satisfied to be an equity loan. Section 50(a) of the constitution discusses permissible liens on a homestead. The context of this section is important in construing the provisions of the amendment. Each requirement under section 50(a)(6) is necessary to have a valid lien on the homestead. A lender or holder's failure to comply with the requirements may result in forfeiture of all principal and interest on the loan if the lender or holder fails to comply with its obligations within a reasonable time after being notified by the borrower of the failure to comply. Clarification of the individual conditions follows:

### 6(A) Voluntary lien

The home equity transaction must be voluntary and must be entered into under a written agreement executed with the consent of each owner and each owner's spouse. Regardless of whether a spouse has a community property interest in the homestead, the consent of that spouse must be obtained. A spouse or owner who is not a maker of the note may acknowledge his or her consent by executing a written consent to the mortgage instrument.

### 6(B) Limitation on loan amount

The amount of the loan is limited to an amount including the aggregate total of outstanding debt against the homestead that does not exceed 80% of the fair market value of the homestead on the date the loan is closed. Thus, the limitation applies to the cash advance and charges at the inception, to the extent any charges are financed in the principal amount of the loan. The determination of the maximum principal amount of the equity loan is based upon the principal balance outstanding on the date the extension of credit is made and does not include interest accrued after the date the extension of credit is made (other than any interest capitalized and added to the principal balance on the date the extension of credit is made), or other amounts advanced by the lender after closing as a result of default, including for example, ad valorem taxes, hazard insurance premiums, and authorized collection costs, including reasonable attorney's fees. On a closed-end multiple advance loan, the principal balance also includes contractually obligated future advances not yet disbursed. For example, on a property with a fair market value of \$100,000 and existing debt on the property of \$30,000, the maximum amount of debt against the property could be \$80,000. Subtracting the outstanding debt of \$30,000, the maximum amount of the new equity loan debt would be \$50,000 on the date the loan is made.

### 6(C) Nonrecourse

The loan is made without recourse for personal liability of each owner and each owner's spouse unless the owner or spouse has committed actual fraud in obtaining the loan. In

essence, a lender may not pursue a deficiency against any owner or any owner's spouse for any unpaid amounts, except in cases of actual fraud.

#### 6(E) Limitation on fees

##### Interest and Fees

A borrower may not be required to pay fees, in addition to any interest, in excess of three percent of the principal amount. The language specifically excludes interest from the limitation. The word "interest" means interest as defined in the *Texas Credit Title* and as interpreted by the courts of the state of Texas. Accordingly, charges that constitute interest under the law, including, for example, points, are not fees subject to the three percent limit. Fees that are required to be paid and that are not interest are subject to the three percent limitation. There is no restriction on a lender absorbing costs that might otherwise be fees and, therefore, covered by the fee limitation.

##### Voluntary Optional Fees

The amendment defines the equity loan as a loan that "does not require the owner ... to pay ... fees ... that exceed ... 3%." The use of the word "require" is determinative in evaluating fees that are subject to the three percent limitation. Charges that are not imposed by the lender, but that are optional, are not fees subject to the three percent fee limit.

A borrower who chooses to pay premiums for certain insurance coverages, but is not required to acquire the insurance coverage as a condition to the extension of credit, does not subject those premiums to the limitation. Credit life and credit accident and health insurance coverages, if elected by the owner, are not included within the three percent limitation. However, if credit life and credit accident and health insurance were required by the lender then these charges would be included in the three percent limitation.

##### Fees to Originate

Fees to originate an equity loan that are not interest fall within the three percent limitation. Fees to third parties for separate and additional consideration for activities relating to originating a loan come within this characterization. For example, attorney's fees for document preparation are fees necessary to originate the loan. A broker's fee is also considered to be a fee to originate the loan.

##### Fees to Evaluate

Fees to evaluate the credit decision for an equity loan that are not interest are subject to the three percent limitation. This includes fees collected to cover the expenses of a credit report, survey, flood zone determination, tax certificate, title report, or appraisal.

##### Fees to Maintain

Fees to maintain the equity loan that are not interest are subject to the three percent limitation. This encompasses a fee charged at the inception of the loan to compensate for performing a service for the life of the loan. Examples of this fee are a flood zone determination fee and a tax service fee.

Fees to Record

Fees paid to public officials and others for the purpose of recording public documents evidencing the lien are fees subject to the three percent limitation.

Fees to Insure

Premiums to insure the equity loan are fees subject to the three percent limitation. Title insurance and mortgage insurance protection are examples of this type of fee.

Fees to Service

Any fee charged to and paid by an owner at the inception of the loan transaction to service the equity loan that is not interest is subject to the three percent limitation.

Escrow Funds

A lender may provide escrow services in a home equity transaction. Funds tendered by the borrower into an escrow account such as for the purpose of taxes, insurance premiums, maintenance or homeowner's association assessments, or similar purposes remain the property of the borrower. Hence, these funds are not subject to the three percent limitation. A lender should not contract for a right of offset against escrow funds pursuant to Section 6(H).

Subsequent Events

The three percent limitation pertains to fees charged to or paid by the owner at the inception of the loan. The lender and owner agree to certain covenants to be performed by both parties after the consummation of the transaction. The parties have a responsibility to perform their respective obligations under the contract after the transaction has been consummated.

If the owner fails to perform, certain events may be triggered that involve the assessment of costs to the owner. One example is the maintenance of homeowner's insurance on the homestead. This type of insurance coverage is normally maintained on all homesteads regardless of whether there is a loan on the property. Certainly, lenders may require borrowers to ensure that a homestead has adequate insurance protection. If the owner fails to maintain homeowner's insurance, the owner has not performed according to the covenants of the agreement. The lender may purchase insurance to maintain coverage on the collateral. This is a subsequent event and is not included in the three percent limitation.

Another example is the assessment of late charges. The assessment of these charges is a subsequent event and arises because of the owner's failure to perform under the agreement. Thus, these charges are not contained within the three percent limitation. Other examples of charges associated with subsequent events are returned check fees, collection costs, and costs associated with foreclosure.

Secondary Mortgage Loans

A secondary mortgage loan as defined in Chapter 3A is limited to the types of fees that may be charged in connection with the loan. These fees are identified in art. 5069-

3A.507 and 3A.508. A lender must comply with the provisions of Chapter 3A and the constitutional restrictions on fees in connection with a secondary mortgage loan.

#### Insurance Premiums

A lender may collect or include in the principal premiums or fees for the sale of insurance on the collateral of an equity loan assuming the lender complies with the rest of the terms of HJR 31 and applicable law concerning the sale of insurance in connection with a mortgage loan.

#### 6(F) No open-end credit

The amendment provides that an equity loan may not be in the form of an open-end account that may be debited from time to time or under which credit may be extended from time to time. An open-end account is defined in article 5069-1B.002(14) as "an account under a written contract between a creditor and an obligor in connection with which:

- (i) the creditor reasonably contemplates repeated transactions and the obligor is authorized to make purchases or borrow money;
- (ii) interest ... may be charged from time to time on an outstanding unpaid balance; and
- (iii) the amount of credit that may be extended during the term of the account is generally made available to the extent that any outstanding balance is repaid..."

If an account is not an open-end account by definition, then it must be a closed-end account. A common type of closed-end secondary mortgage loan (Chapter 3A, Subchapter G) is a type of interim construction loan. The loan has multiple advances at particular stages and interest is only charged upon the principal balance outstanding. No interest is charged on funds that have not been advanced. However, credit is not made available to the extent that outstanding balances have been repaid. This distinction makes this type of loan a closed-end transaction.

Closed-end multiple advance equity loans are permissible within the context of this section. The loan should be structured so that the loan is payable in substantially equal successive monthly installments until the next advance or adjustment period. Each installment must extinguish the accrued interest and contribute to amortizing part of the principal balance.

Amounts advanced by the lender after closing as a result of default, including for example, ad valorem taxes, hazard insurance premiums, and authorized collection costs, including reasonable attorney fees, are not contemplated repeated transactions such that they would characterize the loan as an open-end account.

#### 6(G) No prepayment penalties

A lender may not charge a penalty to a borrower for prepaying a loan or a portion of a loan early. A lockout provision in a loan contract (a provision that prohibits a borrower from paying early) is considered to be a prepayment penalty.

6(H) No additional collateral

No additional real or personal collateral other than the security interest in the homestead is permitted on an equity loan. A lender and an owner may enter into an agreement whereby a lender may acquire an interest in items incidental to the collateral. The following items are not considered additional real or personal collateral:

- (i) escrow for the payment of taxes and insurance;
- (ii) an undivided interest in a condominium unit, a planned unit development, or the right to the use and enjoyment of certain property owned by an association;
- (iii) insurance proceeds related to the homestead; or
- (iv) condemnation proceeds.

A guaranty or the obligation of a cosigner or surety is considered additional collateral, and would not be permissible in connection with an equity loan. An equity loan document should expressly disclaim and waive any and all other security interests securing any other indebtedness now or thereafter owing to the lender. Additionally, a contractual right of offset is also prohibited under this section.

The Texas Constitution and the *Texas Property Code* identify a number of different types of "homesteads" and define an *urban* homestead as consisting of *not more than one acre of land*, together with any improvements thereon. TEX. CONST. ART. XIV, §51 and TEX. PROP. CODE ANN. § 41.002(a) (emphasis added). Any property owned in conjunction with the homestead (one urban acre) that is in excess of one acre is "additional real property."

Lenders are advised to carefully review the legal implications of acquiring a security interest in urban lots that comprise more than one acre.

The occurrence of urban lots exceeding one acre is quite common in many Texas municipalities. The existence of various zoning ordinances and deed restrictions severely hampers efforts to segment lots into portions that do not exceed one acre in many locations. Notwithstanding these difficulties, the Texas Property Code provides a method for a homeowner to designate a portion of a lot as their homestead.

In this method, the borrower identifies the real property to designate as the borrower's one acre homestead in a written document filed with the county clerk. TEX. PROP. CODE ANN. § 41.005(c). Designating the property in this manner is not constructively equal to legally partitioning the property. By following the procedures contained in the *Texas Property Code* to designate a one acre homestead, the borrower ensures that the lender making a home equity loan takes a security interest of not more than one acre of real property.

Although designating a one acre urban homestead may prevent a violation of TEX. CONST. § 50(a)(6)(H), it may present other problems if and when the lender initiates foreclosure proceedings. Often, an urban lot in excess of one acre is subject to a particular zoning ordinance or deed restriction which prohibits the subdivision of the lot. The foreclosure of only the designated one acre segment would constitute a sale of

less than the entire lot and a subdivision of the lot, and as such, may violate the zoning ordinance or deed restriction. This procedure may also require a partition suit (assuming that the borrower's agreement could not be acquired) to have the property sold and the proceeds split between the owners according to their respective ownership.

**6(J) Acceleration prohibited**

A lender may not accelerate an equity loan because of a decrease in the market value of the secured property or because the owner defaults on another indebtedness except a debt secured by a prior valid encumbrance against the homestead. A lender may accelerate a loan because of an owner's default under the covenants of the equity loan, including covenants not to commit waste or not remove property, which indirectly bear on the market value of the homestead. The equity loan documents cannot contain cross-default provisions.

**6(K) Limitation on number of equity loans**

An owner may have only one equity loan (that meets the definition of section 50(a)(6)) at a time, regardless of the aggregate total outstanding debt against the homestead. If the property ceases to be the homestead of the owner, then the lender may treat what was previously a home equity mortgage as a non-homestead mortgage.

**6(L) Repayment schedule**

The loan must be scheduled to be repaid in substantially equal successive monthly installments, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment. The second clause does not specifically state that a portion of principal must be reduced with each payment, but in order to give effect to both clauses of the amendment, to have substantially equal installments would require that some amount of principal must be reduced with each installment. This effectively precludes the permissibility of balloon payments. This provision does not preclude a lender's recovery of payments as necessary for other amounts such as taxes, adverse liens, insurance premiums, collection costs, and similar items.

**6(M) Closing date**

A loan may not be closed before the 12th calendar day after the later of the date that the owner makes application for the loan or the date that the owner receives the required consumer disclosure. The submission of an application to the lender includes the submission to an agent acting on behalf of the lender. An application for a loan may be given orally or electronically and does not have to be in writing. Additionally, the amendment requires that an equity loan may not be closed before the first anniversary of the closing date of any other equity loan secured by the same homestead property. This provision requires that an equity loan may not be refinanced before one year has elapsed since the loan's closing date.

**6(N) Place of closing**

An equity loan may be closed only at an office of the lender, an attorney at law, or a title company. For purposes of this section, the lender is any lender that is authorized pursuant to section 6(P), that either advances funds directly to the owner or is identified as the payee on the note. If the transaction is closed at one of these offices, but lacks the

consent of a spouse or other party, it is permissible to obtain that individual's consent by mail. A properly executed power of attorney is acceptable for designating an individual to close the loan on behalf of the owner.

#### 6(O) Rate of interest charge

A lender may charge a fixed or variable rate of interest as authorized by statute. As discussed above, interest rates on certain first mortgages are not limited on loans subject to the federal Depository Institutions Deregulation and Monetary Control Act of 1980 and the Alternative Mortgage Transaction Parity Act. Chapter 3A authorizes the maximum rate on secondary mortgage loans. The authorization of a variable interest rate is ambiguous when read in connection with the provision relating to substantially equal successive monthly installments. In construing the constitution, provisions are viewed broadly giving maximum effect to all sections and phrases. Thus, an equity loan providing in accordance with applicable law for an interest rate that varies from time to time may provide for a payment amount that varies from time to time, assuming that the loan is regularly amortizing and that the rate adjusts on a regular basis, such as annually. The amount of the payment should not change more frequently than the interest rate adjustment. The scheduled payment amount between each payment change date should be substantially equal and the amount of the payment should equal or exceed the amount of interest scheduled to accrue between each payment date.

An adjustable rate loan may provide for discount interest that results in a low initial interest rate. An equity loan must be structured in a way such that the transaction regularly amortizes, contributes to amortization of principal, and does not result in a balloon payment.

#### 6(P) Authorized lenders

An equity loan may be:

"made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area:

- (i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or the United States;
- (ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;
- (iii) a person licensed to make regulated loans, as provided by statute of this state;
- (iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase; or
- (v) a person who is related to the homestead owner within the second degree of affinity and consanguinity..."

Unless a lender meets the definitions of (i), (ii), (iv), or (v), the lender must obtain a regulated loan license to meet the provisions of (iii). It is important to review the provisions of Chapter 3A regarding licensing as well as the statutory provisions regarding secondary mortgage loans. A secondary mortgage loan made, negotiated, or arranged

at a rate of interest in excess of 10% must be made by an authorized lender. An authorized lender is defined by statute to be a bank, savings and loan association, savings bank, credit union, or the holder of a regulated loan license. These qualifications are inclusive of the constitutional amendment. In other words, a lender must meet both sets of qualifications, those of the constitution and the statute, in order to make an equity loan that is a secondary mortgage loan. Constitutional law should be interpreted in harmony with statutory law.

#### Depository Institutions

A bank, savings and loan association, savings bank, or credit union doing business under the laws of this state or of the United States is defined as an authorized lender. The provisions of Chapter 3A regarding the definitions of authorized lenders reflect a similar listing of depository institutions. However, the consumer credit commissioner has interpreted the applicability of these standards to banks chartered in other states. Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 exempts state-chartered insured banks from any procedural requirements of other states related to interest rate restrictions, including licensing, otherwise applicable to lenders imposing such interest rates. [Consumer credit commissioner interpretation letter 85-4] Thus, a bank chartered in another state need not obtain a regulated loan license.

#### HUD-Approved Mortgagees

A person approved as a mortgagee by the United States government to make federally insured loans is an authorized lender. The Department of Housing and Urban Development (HUD) approves lenders to make federally insured loans. A HUD-approved mortgagee is entitled to make equity loans. Under the terms of the amendment, a HUD-approved mortgagee may make equity loans as first mortgage loans or secondary mortgage loans at a rate of interest of 10% or below. If a HUD-approved mortgagee makes a secondary mortgage loan at a rate greater than 10%, then the HUD-approved mortgagee should comply with the provisions of Chapter 3A regarding licensure.

#### Mortgage Brokers

A mortgage broker must be licensed to make loans. The constitutional amendment only refers to an equity loan "made" by a lender. Making a loan is the process of determining to extend the credit, the act of funding a loan, or being identified as the "payee" of the note. If the loan documents recognize a person as making or originating the loan and then the transaction is immediately assigned (often referred to as "table funding") to the ultimate lender, both of these lenders (the originator and the funder) must be licensed or otherwise qualify as authorized lenders. A person who only arranges loans does not necessarily fall into this category. Again, one must look to the provisions of Chapter 3A regarding activities that require a license. Thus, a broker negotiating or arranging secondary mortgage equity loans at an interest rate greater than 10% must be licensed. A mortgage broker only arranging a first lien equity loan or a cash-out refinance need not be licensed if the broker did not "make" the loan.

#### 6(Q) (i)      Limitation on application of proceeds



COPY

SCOTT H. JENKINS  
Judge  
(512) 854-9308

LAWRENCE ANDREWS  
Baillif  
(512) 854-9397

NANCY HERRERA  
Judicial Aide  
(512) 854-9303

53RD DISTRICT COURT  
TRAVIS COUNTY COURTHOUSE  
P. O. BOX 1748  
AUSTIN, TEXAS 78767  
FAX (512) 854-9392

CHAVELA PRINCE  
Official Reporter  
(512) 854-9322

CONNIE JEFFERSON  
Court Clerk  
(512) 854-9457

BARBARA HANNON  
Staff Attorney  
(512) 854-9366

October 7, 2005

Ms. Ann Hartley  
Assistant Attorney General  
Financial Litigation Division  
P.O. Box 12548  
Austin, Texas 78711  
Via Facsimile: (512) 477-2348

Mr. Robert Doggett  
Texas Rio Grande Legal Aid  
2201 Post Road, Suite 104  
Austin, Texas 78704  
Via Facsimile: (512) 477-3940

Mr. Stephen Gardner  
Law Office of Stephen Gardner, PC  
6060 North Central Expressway, Suite 560  
Dallas, Texas 75206  
Via Facsimile: (214) 800-2834

Filed in The District Court  
of Travis County, Texas  
on 10.7.05  
at 2:30 P.M.  
Amalia Rodriguez-Mercoza, Clerk

Re: Cause No. GN400269; *ACORN, et al. vs. Finance Commission of Texas, et al* in  
the 126<sup>th</sup> Judicial District, Travis County, Texas

Dear Counsel:

I have concluded my consideration of your cross motions for Summary Judgment and I am writing to let you know about the decisions I have made. I will list these as points 1 through 10, though in some of the briefing they have been referred to as A through J.

Point 1, Rule 153.5: During oral argument, counsel for Defendants took the position that every charge made by the lender to originate, evaluate, maintain, or service the loan would be construed, under usury law, as interest; and therefore, none of these charges could ever be subject to the three percent cap. This would mean of course that, with respect to a lender, the three percent cap would be essentially meaningless. Unless there were charges incurred by the lender which were paid to a third party, and reimbursed by the borrower, all other charges would be interest, and it is hard to imagine how the three percent cap could ever be of any significance. Furthermore, adopting Defendants' use of usury law to interpret the Constitution so that it is "consistent" would mean that any change in usury law by the legislature could necessarily dictate a new and different interpretation of the Constitution.

I noted with interest that defense counsel's concluding argument (in her brief at the top of page 16) is that the challenged interpretation, 7 TAC 153.5, does not conflict with the Texas constitution, Article 16, Section 50 (a)(6)(E) by specifying that "discount points" are interest and are not subject to the three percent cap that limits fees. Therein lies the problem. The agencies did not specify "discount points." The agencies elected to merely use the word "points" in 153.5(3). As we all know, all points are not discount points. Discount points are essentially pre-payment of interest. They are a payment (each point being one percent of the loan amount) in exchange for a correspondingly lower monthly rate of interest. This process was explained by the Waco Court in the *Tarver* case. Compare this to the *Thomison* case, in which the borrower paid a one percent "origination fee." Though the fee was exactly one percent of the total loan, and therefore was a point, Judge Nowlin had no difficulty in finding that the "origination fee" was subject to the three percent cap in the Constitution. He distinguished discount points in a footnote and declined to reach the question of whether discount points were subject to the three percent cap. As I mentioned to counsel during oral argument, it seems to this Court that since discount points are clearly a pre-payment of interest and measurably correspond to a lower monthly interest rate, it would be reasonable to have a rule that clarifies that discount points are not subject to the three percent cap.

Under the agencies' rules, and in particular Rule 153.5(3), a lender could charge a point to originate the loan, a point to evaluate the loan, a point to maintain the loan, and a point to service the loan, and even though none of those points bore any relationship to the monthly interest rate being charged the borrower, they would not be subject to the three percent cap. In fact, it would not matter whether any of these charges were in the form of points. Because all of these charges by the lender are considered, at present, interest (as that term is technically defined in usury law), they are not subject to the three percent cap. Because this seems so contrary to the clear language, purpose and intent of Article 16, Section 50 (a)(6)(E), I have decided to rule for the Plaintiffs on this point.

**Point 2, Rule 153.10:** This point was withdrawn by counsel for Plaintiffs during oral argument, and the parties have agreed that it need not be addressed by the Court.

**Point 3, Rule 159.12:** The Constitutional language in question which prevents the closing from occurring before the twelfth day after the date that the owner "submits an application" evinces a clear intent for there to be a more formal application process by the owner than by merely saying "I would like to apply." While an electronic application that is substantially the same as one that would be done on paper would certainly suffice, the Rule allowing for an oral application creates ambiguity, confusion, and hardly seems consistent with the language and clear intent of the twelve day waiting period following a formal application. The plaintiffs prevail on this point.

Point 4, Rule 153.13: If for no other reason than that Rule 153.13 (4)(B) so clearly violates the Constitution, Plaintiffs prevail on this point as well. During oral argument, counsel for Defendants declined to answer the Court's question about whether this particular part of the rule violated the Constitutional provision in question. That is because this portion of the rule is so poorly drafted as to allow for a dramatic increase in the total amount of the actual fees, costs, points and charges on the date of closing over the amount in the pre-closing disclosure, provided that just one of the items of the charges decreases. Plaintiffs prevail on this point.

Point 5, Rule 153.15: Because I have concluded that this rule does not contradict the Constitutional provision in question, the Defendants prevail on this point.

Point 6, Rule 153.18 (3): The only reason for this particular subpart of the Rule is to allow lenders to have an owner submit an application to consolidate a non-homestead loan of that very lender in order to convert it to a homestead loan. This is precisely what the Constitution was intended to prevent. If that is not the meaning of the Rule, then it serves no purpose. Counsel for Defendants argues that this particular section can be interpreted to be consistent with the Constitution by concluding that it is not intended to allow the lender to consolidate its own non-homestead loan to a homestead loan by persuading the owner to fill out such an application. The Constitution, however, already allows the lender to require a debt consolidation if the debt is to another lender or if the prior debt is already secured by the homestead. What purpose then would subsection 3 of the rule serve other than to allow a lender to convert its own non-homestead debt to a homestead loan by "persuading" the borrower to fill out such an application? In fact, if Defendants have correctly "interpreted" the Constitution in Rule 153.12 (See Point 3 above), then the borrower could be persuaded to orally make this application. Plaintiffs prevail on this point.

Point 7, Rule 153.20: The rule is inconsistent with, and diminishes the protections of the Constitution, and Plaintiffs prevail on this point as well.

Point 8, Rule 153.22: For the same reasons as point 7, Plaintiffs prevail on this point.

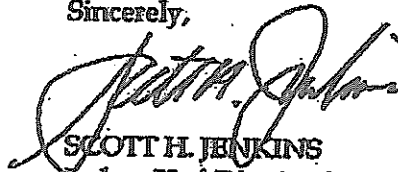
Point 9, Rule 153.51: Because I have concluded that the language in the rule being challenged by the Plaintiffs is not inconsistent with the Constitutional provision in question, the Defendants prevail on this point.

Point 10, Rule 153.84: The Constitutional prohibition of "preprinted solicitation check(s)" does not necessarily mean that all other "checks" are permitted. To determine whether "convenience checks" are prohibited by the Constitution, it is necessary to discern the meaning of the entire provision in question, which prohibits the use of "credit cards, debit cards, preprinted solicitation check, or similar device...".

The Defendants correctly point out on page 41 of their brief and Cross Motion, that the key to deciding this challenge is the phrase "similar device". They then go on to reference, in support of their position, the statutory definition of "credit card" found in Finance Code Sec. 346.001(2). The Defendants, however, have ignored the very definition that they cite, which equates "check" and "credit card". Furthermore, Finance Code Sec. 301.002(2), which Defendants do not cite, includes the use of a "check" when defining "credit card transaction." How then can Defendants maintain that a "convenience check" is not a prohibited "similar device"? Statutory definitions alone, however, as discussed under Point 1, are not determinative when interpreting the language of our Constitution adopted by the people of Texas. The reason that "convenience checks" are prohibited, is that, in fact, they seem so clearly to be a "similar device." Plaintiffs prevail on this point.

Please provide an order for the Court's signature which has been approved as to form by all counsel. Thank you for the manner in which you presented these motions and for your assistance to the Court.

Sincerely,



SCOTT H. JENKINS  
Judge, 53rd District Court  
Travis County, Texas

Orig: Ms. Amalia Rodriguez-Mendoza, Travis County District Clerk

ASSOCIATION OF COMMUNITY	)	IN THE DISTRICT COURT
ORGANIZATIONS FOR REFORM NOW	)	
(ACORN), VALERIE NORWOOD,	)	
ELSIE SHOWS, MARYANN	)	
ROBLES-VALDEZ, BOBBY MARTIN,	)	
PAMELA COOPER, and CARLOS RIVAS,	)	
	)	
PLAINTIFFS,	)	
	)	
VS.	)	
	)	
FINANCE COMMISSION of TEXAS, and	)	OF TRAVIS COUNTY, TEXAS
CREDIT UNION COMMISSION of TEXAS,	)	
	)	
DEFENDANTS,	)	
	)	
VS.	)	
	)	
TEXAS BANKERS ASSOCIATION,	)	
	)	
DEFENDANT-INTERVENOR.	)	126th JUDICIAL DISTRICT

**FINAL SUMMARY JUDGMENT AND TEMPORARY STAY ORDER**

Plaintiffs challenge the validity of rules adopted by Defendants Finance Commission of Texas and Credit Union Commission of Texas which purport to interpret Article XVI, Section 50(a)(6) of the Texas Constitution. Defendants along with Intervenor Texas Bankers Association defended the rules. There are no genuine issues of material fact, and the parties are entitled to judgment as a matter of law. The Court has considered all pleadings, motions, cross motions, responses, replies and other materials filed with the Court. After consideration of these materials and considering arguments of counsel, the Court ORDERS and declares the following rules invalid or denies Plaintiffs relief:

1. Rules 7 TAC 153.1(11), 153.5(3), (4), (6), (8), (9), and (12) are invalid;

2. Rule 7 TAC 153.12(2) is invalid as to orally submitted applications, and not invalid as to electronically submitted applications;

3. Rule 7 TAC 153.13(4) is invalid;

4. Plaintiffs' challenge to Rules 7 TAC 153.15(2) and (3) is denied;

5. Rule 7 TAC 153.18(3) is invalid;

6. Rule 7 TAC 153.20 is invalid;

7. Rule 7 TAC 153.22 is invalid;

8. Plaintiffs' challenge to Rules 7 TAC 153.51(1) and (3) is denied; and


9. Rule 7 TAC 153.84(1) is invalid.

It is further ORDERED that this judgment is stayed in all respects for thirty days, and the rules declared to be invalid by this judgment remain in effect during that time regardless of whether this judgment is superseded by the posting of a bond, filing a notice of appeal or other action of a party.

All other relief requested by any party is denied. Costs are taxed against Defendants.

This order disposes of all claims and all parties and is final and appealable.

Signed this 29<sup>th</sup> day of April, 2006.

  
\_\_\_\_\_  
JUDGE SCOTT JENKINS  
53<sup>rd</sup> District Court, Travis County, Texas

**APPENDIX E**  
**TEXAS RULE OF CIVIL PROCEDURE**

**RULE 735 Procedures.**

A party seeking to foreclose a lien created under Tex. Const. art. XVI, § 50(a)(6), for [a] home equity loan, or Tex. Const. art. XVI, § 50(a)(7), for a reverse mortgage, that is to be foreclosed on grounds other than Tex. Const. art. XVI, §§ 50(k)(6)(A) or (B), may file: (1) a suit seeking judicial foreclosure; (2) a suit or counterclaim seeking a final judgment which includes an order allowing foreclosure under the security instrument and Tex. Prop. Code § 51.002; or (3) an application under Rule 736 for an order allowing foreclosure.

**Rule 736 Expedited Foreclosure Proceeding.**

1. *Application.* --A party filing an application under Rule 736 seeking a court order allowing the foreclosure of a lien under Tex. Const. art. XVI, § 50(a)(6)(D), for a home equity loan, or § 50(k)(11), for a reverse mortgage, shall initiate such in rem proceeding by filing a verified application in the district court in any county where all or any part of the real property encumbered by the lien sought to be foreclosed (the "property") is located. The application shall:
  - (A) be styled: "In re: Order for Foreclosure Concerning (*Name of person to receive notice of foreclosure*) and (*Property Mailing Address*)";
  - (B) identify by name the party who, according to the records of the holder of the debt, is obligated to pay the debt secured by the property;
  - (C) identify the property by mailing address and legal description;
  - (D) identify the security instrument encumbering the property by reference to volume and page, clerk's file number or other identifying recording information found in the official real property records of the county where all or any part of the property is located or attach a legible copy of the security instrument;
  - (E) allege that:
    - (1) a debt exists;
    - (2) the debt is secured by a lien created under Tex. Const. art. XVI, § 50(a)(6), for a home equity loan, or § 50(a)(7), for a reverse mortgage;
    - (3) a default under the security instrument exists;

- (4) the applicant has given the requisite notices to cure the default and accelerate the maturity of the debt under the security instrument, Tex. Prop. Code § 51.002, Tex.Const. art. XVI, § 50(k)(10), for a reverse mortgage, and applicable law;
- (F) describe facts which establish the existence of a default under the security instrument; and
- (G) state that the applicant seeks a court order required by Tex. Const. art. XVI, § 50(a)(6)(D), for a home equity loan, or § 50(k)(11), for a reverse mortgage, to sell the property under the security instrument and Tex. Prop. Code § 51.002.

A notice required by Tex. Const. art. XVI, § 50(k)(10), for a reverse mortgage, may be combined or incorporated in any other notice referenced in Rule 736(1)(E)(4). The verified application and any supporting affidavit shall be made on personal knowledge and shall set forth such facts as would be admissible in evidence, provided that facts may be stated based upon information and belief if the grounds of such belief are specifically stated.

2. *Notice.*

- (A) *Service.* --Every application filed with the clerk of the court shall be served by the party filing the application. Service of the application and notice shall be by delivery of a copy to the party to be served by certified and first class mail addressed to each party who, according to the records of the holder of the debt is obligated to pay the debt. Service shall be complete upon the deposit of the application and notice, enclosed in a postage prepaid and properly addressed wrapper, in a post office or official depository under the care and custody of the United States Postal Service. If the respondent is represented by an attorney and the applicant's attorney has knowledge of the name and address of the attorney, an additional copy of the application and notice shall be sent to respondent's attorney.
- (B) *Certificate of Service.* --The applicant or applicant's attorney shall certify to the court compliance with the service requirements of Rule 736. The applicant shall file a copy of the notice and the certificate of service with the clerk of the court. The certificate of service shall be prima facie evidence of the fact of service.

(C) *Form of Notice.* --The notice shall be sufficient if it is in substantially the following form in at least ten point type:

Cause No.

In re: Order for Foreclosure In the District Court  
Concerning Cause No. \*(1) Of County  
and \*(2) Judicial District

NOTICE TO \*(3)

An application has been filed by , as Applicant, on \*(4), in a proceeding described as:

"In re: Order for Foreclosure Concerning \*(1) and \*(2).

The attached application alleges that you, the Respondent, are in default under a security instrument creating a lien on your homestead under Tex. Const. art. XVI, § 50(a)(6), for a home equity loan, or § 50(a)(7), for a reverse mortgage. This application is now pending in this court.

Applicant seeks a court order, as required by Tex. Const. art. XVI, § 50(a)(6)(D) or § 50(k)(11), to allow it to sell at public auction the property described in the attached application under the security instrument and Tex. Prop. Code § 51.002.

You may employ an attorney. If you or your attorney do not file a written response with the clerk of the court at \*(5) on or before 10:00 a.m. on \*(6) an order authorizing a foreclosure sale may be signed. If the court grants the application, the foreclosure sale will be conducted under the security instrument and Tex. Prop. Code § 51-002.

You may file a response setting out as many matters, whether of law or fact, as you consider may be necessary and pertinent to contest the application. If a response is filed, the court will hold a hearing at the request of the applicant or respondent.

*In your response to this application, you must provide your mailing address. In addition, you must send a copy of your response to \*(7).*

ISSUED

By

*(Applicant or Attorney for Applicant)*

## CERTIFICATE OF SERVICE

I certify that a true and correct copy of this notice with a copy of the application was sent certified and regular mail to \*(3) on the day of , 20 ].

*(signature)*  
*(Applicant or Attorney for Applicant)*

\*(1) name of respondent \*(5) address of clerk of court  
\*(2) mailing address of property \*(6) response due date  
\*(3) name and address of respondent \*(7) name and address of applicant  
\*(4) date application filed or applicant's attorney

(D) The applicant shall state in the notice the date the response is due in accordance with Rule 736(3).

(E) The application and notice may be accompanied by any other notice required by state or federal law.

3. *Response Due Date.* --A response is due on or before 10:00 a.m. on the first Monday after the expiration of thirty-eight (38) days after the date of mailing of the application and notice to respondent, exclusive of the date of mailing, as set forth in the certificate of service.
4. *Response.*
  - (A) The respondent may file a response setting out as many matters, whether of law or fact, as respondent deems necessary or pertinent to contest the application. Such response and any supporting affidavit shall be made on personal knowledge and shall set forth such facts as would be admissible in evidence, provided that facts may be stated based upon information and belief if the grounds of such belief are specifically stated.
  - (B) The response shall state the respondent's mailing address.
  - (C) The response shall be filed with the clerk of the court. The respondent shall also send a copy of the response to the applicant or the applicant's attorney at the address set out in the notice.

5. *Default.* --At any time after a response is due, the court shall grant the application without further notice or hearing if:
  - (A) the application complies with Rule 736(1);
  - (B) the respondent has not previously filed a response; and
  - (C) a copy of the notice and the certificate of service shall have been on file with the clerk of the court for at least ten days exclusive of the date of filing.
6. *Hearing When Response Filed.* --On the filing of a response, the application shall be promptly heard after reasonable notice to the applicant and the respondent. No discovery of any kind shall be permitted in a proceeding under Rule 736. Unless the parties agree to an extension of time, the issue shall be determined by the court not later than ten business days after a request for hearing by either party. At the hearing, the applicant shall have the burden to prove by affidavits on file or evidence presented the grounds for the granting of the order sought in the application.
7. *Only Issue.* --The only issue to be determined under Rule 736 shall be the right of the applicant to obtain an order to proceed with foreclosure under the security instrument and Tex. Prop. Code § 51.002.
8. *Order to Proceed with Notice of Sale and Sale.*
  - (A) *Grant or Denial.* --The court shall grant the application if the court finds applicant has proved the elements of Rule 736(1)(E). Otherwise, the court shall deny the application. The granting or denial of the application is not an appealable order.
  - (B) *Form of Order.* --The order shall recite the mailing address and legal description of the property, direct that foreclosure proceed under the security instrument and Tex. Prop. Code § 51.002, provide that a copy of the order shall be sent to respondent with the notice of sale, provide that applicant may communicate with the respondent and all third parties reasonably necessary to conduct the foreclosure sale, and, if respondent is represented by counsel, direct that notice of the foreclosure sale date shall also be mailed to counsel by certified mail.
  - (C) *Filing of Order.* --The applicant is to file a certified copy of the order in the real property records of the county where the property is located within ten business days of the entry of the order. Failure to timely record the order shall not affect the validity of the foreclosure or defeat the presumption of Tex. Const. art. XVI, § 50(I).
9. *Nonpreclusive Effect of Order.* --No order or determination of fact or law under Rule 736 shall be res judicata or constitute collateral estoppel or estoppel by judgment in any other proceeding or suit. The granting of an application under these rules shall be without prejudice

to the right of the respondent to seek relief at law or in equity in any court of competent jurisdiction. The denial of an application under these rules shall be without prejudice to the right of the applicant to re-file the application or seek other relief at law or in equity in any court of competent jurisdiction.

10. *Abatement and Dismissal.* --A proceeding under Rule 736 is automatically abated if, before the signing of the order, notice is filed with the clerk of the court in which the application is pending that respondent has filed a petition contesting the right to foreclose in a district court in the county where the application is pending. A proceeding that has been abated shall be dismissed.



ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

## MORTGAGEE LETTER 2006-06

**TO:** ALL FHA APPROVED MORTGAGEES  
ALL HUD APPROVED HOUSING COUNSELING AGENCIES

**SUBJECT:** Home Equity Conversion Mortgage Program – Line of Credit Payment  
Option for Texas- Single Family

Effective for all Home Equity Conversion Mortgages (HECM) closed on or after March 1, 2006, the Federal Housing Administration (FHA) will permit borrowers in Texas to choose a line of credit payment option. The provisions contained in this Mortgagee Letter will replace previously issued guidance found in Mortgagee Letter 00-09, ML 00-34, and ML 00-39 on the same topics.

### Background

On March 8, 2000, in ML 00-09, FHA announced that only certain payment options were available for HECM loans originated in the State of Texas. At that time, the Texas Constitution: 1) restricted the line of credit payment option, thereby limiting homeowners to 3 payment plan options (lump sum at closing, term and tenure) and 2) placed special restrictions on mortgage acceleration due to non-occupancy and homeowner's refusal to allow the lender to inspect the property.

On November 8, 2005, voters in Texas ratified an amendment to the Constitution to authorize line of credit advances under home equity reverse mortgages. With the amendment being ratified on November 23, 2005, elderly homeowners now have the flexibility to select from five (5) HECM payment options, which are currently available to all HECM borrowers. The five HECM payment options are:

- Tenure (regular monthly payments so long as HECM borrower occupies the property)
- Term (regular monthly payments for a specific period of time selected by HECM borrower)
- Line of Credit (unscheduled advances at the HECM borrower's request)
- Modified Tenure (combination of tenure and line of credit payment options)
- Modified Term (combination of term and line of credit payment options)

The Constitutional amendment prohibits certain practices in extending lines of credit in reverse mortgage lending 1) borrowers are prohibited from using a credit card, debit card, preprinted solicitation checks or similar devices to obtain an advance; 2) after the extension of credit is

established, lenders cannot charge or collect a transaction fee solely in connection with any debit or loan advance; and 3) lenders cannot unilaterally amend the terms of the document administering the extension of credit.

## Forms

Lenders must adapt all forms to ensure compliance with existing FHA requirements, and Texas Constitution and statutes. Lenders should:

- Insert line of credit language that was deleted in 2000;
- Insert the prohibition on HECM borrowers using a credit card, debit card, preprinted solicitation checks, or similar devices to obtain an advance;
- Insert the prohibition against lenders charging or collecting a transaction fee solely in connection with any debit or loan advance; and
- Insert the prohibition against lenders unilaterally amending the terms of the document administering the extension of credit.

The validity and enforceability of the mortgage and note will depend on compliance with state law and therefore HUD emphasizes the need for a lender to adapt the mortgage and note, accordingly. FHA strongly encourages lenders to seek counsel's advice that State law has been considered and that any necessary changes to the instruments have been made.

## Loan Agreement – Repair Rider

Lenders are no longer required to escrow amounts for repairs completed after closing. Instead, lenders must establish a repair set aside that is at a minimum equal to 150 percent of the cost of repairs, plus the repair administration fee, and consistent with existing HECM policy. The repair administrative fee cannot exceed the greater of one and one-half percent of the funds used for repairs or fifty dollars.

## Loan Closing

Upon the expiration of the three day right of rescission, initial disbursements from the principal limit can be made. After closing, net principal limit disbursements for term and tenure should be disbursed on the first business day of each month. Lenders are required to disburse line of credit payments within five business days of receiving a written request for payment from the HECM borrower.

Lenders are subject to late charges from their own funds if they are unable to mail or electronically transfer a scheduled monthly payment on the first business day of the month or make a line of credit payment within five business days after receiving a written request from a HECM borrower for payment.

### Disbursements by Lender

Lenders can disburse payments at any time on behalf of the borrower when the borrower elects to require the lender to use loan advances for payment of property charges consisting of taxes, hazard insurance premiums, ground rents, and special assessments or when repairs are completed after closing and the property has been inspected by a HUD-approved inspector. In addition, lenders can disburse payments for the protection of their interest at any time. Events that trigger the disbursement of payments in order to protect the HECM lender's interest include, but are not limited to: the HECM borrower's failure to pay property taxes, the HECM borrower's failure to pay ground rents, the HECM borrower's failure to pay flood insurance, and the HECM borrower's failure to pay hazard insurance premiums.

HECM borrowers must refinance their existing FHA insured HECM loan to take advantage of the line of credit payment option. The lender should also inform HECM borrowers about reasonable and customary charges that are acceptable to FHA, thereby providing a safeguard against equity stripping, which FHA strictly prohibits.

### Application of Funds Received by Lender

Any funds received by the lender for the benefit of the HECM borrower, such as a condemnation award, may only be credited to the borrower's account in accordance with the applicable law. Prepayments, however, made by the HECM borrower must be credited to the borrower's account on the date received by the lender.

### Acceleration of the Mortgage

Although the constitutional amendment now permits the line of credit payment option, special restrictions on mortgage acceleration due to non-occupancy and borrower's refusal to allow the lender to inspect the property are still in effect. The reasons for accelerating the debt have not changed, however, we are providing the exact language of the Texas Constitution (Article XVI, Section 50 (k)(6)(C)) for your convenience.

Mortgage Acceleration, Occupancy --- Article XVI, Section 50(k)(6)(C) of the Texas Constitution provides that a payment of principal or interest is due (i.e., acceleration) when all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval from the lender.

Mortgage Acceleration, Property Inspections --- Under 24 CFR 206.27(c)(2)(iii), the mortgagee can accelerate the loan if an obligation of the borrower under the security instrument is not performed. However, the provisions of the Texas State Constitution preclude acceleration for -the homeowner's refusal to allow the lender to inspect the property. Therefore, for Texas HECMs only, lenders may not accelerate the mortgage due to the homeowner's refusal to allow the lender to inspect the property.

*Foreclosures*

Lenders are reminded that there are specific foreclosure procedures for HECMs within the State of Texas; therefore, lenders should follow the requirements and instructions outlined in the Texas Constitution (Article XVI, sections 50 (a)(6) and (7)). Foreclosure procedures should be placed under the non-uniform covenants of the Deed of Trust forms. The form should use the foreclosure procedures paragraph of the current approved Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) form (including language regarding payment of costs such as attorney's fees) as a guide with any necessary adaptation to conform to FHA instructions and applicable law. Any special language or notices required by applicable law should appear following the non-uniform covenants using the Fannie Mae and Freddie Mac form as a guide.

If you have any questions regarding this Mortgagee Letter, please contact the Department of Housing and Urban Development's Denver Homeownership Center at (800) 543-9378.

Sincerely,

Brian D. Montgomery  
Assistant Secretary for Housing-  
Federal Housing Commissioner



## REVERSE MORTGAGE LENDER LETTER 2006-2

February 23, 2006

TO: Reverse Mortgage Lenders

SUBJECT: Texas Reverse Mortgage Loans

In 1999, an amendment to the Texas Constitution authorized lenders to impose liens on Texas homestead properties securing reverse mortgage loans. However, the 1999 amendment authorizing such liens imposed certain limitations on the origination and servicing of reverse mortgage loans, including prohibiting the use of line of credit features

On November 8, 2005, this prohibition was eliminated when Texas citizens voted to allow line of credit features as an option under reverse mortgage loans. Specifically, voters approved Proposition 7, which amended the existing Section 50(p), Article XVI of the Texas Constitution to authorize line of credit advances under a Texas reverse mortgage loan. A new Section 50(v), Article XVI of the Texas Constitution also was enacted as part of Proposition 7; it requires the reverse mortgage loan security instrument to specifically prohibit (1) the use of credit cards and similar devices to obtain an advance, (2) the charging of transaction fees solely in connection with any debit or advance after loan settlement, and (3) the unilateral amendment of loan terms by the lender or holder of a reverse mortgage loan. These amendments to the Texas Constitution became effective November 23, 2005 and are not retroactive.

Proposition 7 effectively places Texas on equal footing with other states. For example, Texas now authorizes lenders to provide (1) payment plans with line of credit features, (2) initial advances at any time, and (3) future advances at times and in amounts requested by the borrower, which would include funds to be advanced from repair set-asides for required repairs. Therefore, effective immediately Fannie Mae expressly repeals in its entirety Reverse Mortgage Lender Letter 2000-11 issued on November 7, 2000 pertaining to the purchase of Home Keeper® and HECM reverse mortgage loans secured by properties in Texas.

Proposition 7 enables a lender to originate Texas Home Keeper reverse mortgage loans with all of the plans available under the product, including the line of credit, tenure, and modified tenure payment plans. Beginning March 1, 2006, Fannie Mae will commence purchase of Texas Home Keeper reverse mortgage loans with line of credit features and other terms authorized by Proposition 7.

Proposition 7 also makes it possible for HUD to insure Texas HECM reverse mortgage loans with the line of credit, modified term, or modified tenure payment plans. Please contact HUD for further details and guidance. Fannie Mae plans to begin purchasing

annually and monthly adjusting FHA-insured HECM reverse mortgage loans secured by Texas homestead properties, provided that (1) HUD issues guidance stating that it will insure such FHA-insured HECM reverse mortgage loans, and (2) such FHA-insured HECM reverse mortgage loans comply with all applicable law and HUD guidance. However, Fannie Mae will not purchase such FHA-insured HECM reverse mortgage loans earlier than March 1, 2006.

Reverse mortgage loans purchased on or after March 1, 2006 must comply with the requirements of this Reverse Mortgage Lender Letter 2006-02 and be documented on updated reverse mortgage loan document forms drafted by lenders that incorporate line of credit and other terms authorized by the Proposition 7 amendment to the Texas Constitution. By delivering a reverse mortgage loan to Fannie Mae, the lender represents and warrants to Fannie Mae that the reverse mortgage loan documents (1) comply with all applicable local, state and federal law, (2) comply fully with the Fannie Mae Selling Guide, the Fannie Mae Servicing Guide, and the Fannie Mae Reverse Mortgage Selling and Servicing Guide, and (3) are enforceable in accordance with their terms. Moreover, by delivering any nonstandard instrument (e.g., HECM and any amended Home Keeper mortgages) to Fannie Mae, the lender makes the relevant nonstandard instrument warranties as set forth in the Fannie Mae Selling Guide, Part 1, Chapter 2, Section 202.01.

In order to make the representation and warranty that the reverse mortgage loan documents are enforceable under their terms and in compliance with all applicable law, we *strongly advise* you to consult with Texas counsel when drafting the Texas reverse mortgage loan documents. There are a number of issues the lender should consider, including but not limited to, whether: (1) the security instrument must expressly state the enumerated limitations provided in Section 50(v); (2) the \$50 recalculation fee may violate the Section 50(v) prohibition against transaction fees charged after loan settlement; (3) special account checks may violate the Section 50(v) prohibition against using a device similar to a credit card, debit card, or preprinted solicitation check; (4) withholding loan advances or adjusting the principal amount of the loan may violate the Section 50(v) prohibition against unilateral amendments; and (5) the language in the Repair Rider to the Loan Agreement is sufficient to authorize future advances for repairs "at times and in amounts requested by the borrower" as required by Section 50(p)(4). Furthermore, Texas loan acceleration, foreclosure and disclosure provisions are unique. If Fannie Mae determines that the lender did not fully comply with its representations and warranties, Fannie Mae's remedies include, but are not limited to, requiring the lender to repurchase the reverse mortgage loan.

In addition, note that lenders must be cautious when existing Texas reverse mortgage loan borrowers request payment plan changes. Neither the Texas Home Keeper reverse mortgage loan document forms repealed by this Reverse Mortgage Lender Letter 2006-2 nor the Texas HECM reverse mortgage loans document forms published in HUD Mortgage Letters 00-09, 00-34, or 00-39 contemplate payment plans with line of credit features. Consequently, given that the Proposition 7 amendment is not retroactive, if the reverse mortgage loan documents that were signed by the borrower did not discuss

payment plans with line of credit features, a lender cannot permit the borrower to opt for a payment plan with a line of credit feature (i.e., line of credit, modified term, modified tenure). Rather, the borrower will have to refinance the reverse mortgage loan in order to obtain line of credit features.

The terms of this Reverse Mortgage Lender Letter modify the Guides. For questions, please contact Dave Carey at (978) 468-9932 or [david\\_s\\_carey@fanniemae.com](mailto:david_s_carey@fanniemae.com) or contact Kathy Hardy at (202) 752-2301 or [kathleen\\_m\\_hardy@fanniemae.com](mailto:kathleen_m_hardy@fanniemae.com).