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To: Clients and Friends

From: David F. Dulock

Subject: 2017 Legislative Update I – Proposed Constitutional Amendments

The Regular Session of the 85th Texas Legislature (85(R) – 2017), which ended May 29, 2017, proposed only seven constitutional amendments. For these amendments to take effect, they must be approved by a majority of Texas voters at an election to be held November 7, 2017. Only four of these proposed constitutional amendments and the three proposed enabling legislative bills are the subject of this legislative update.

SENATE JOINT RESOLUTION NO. 60 (SJR 60)

SJR 60 proposes to amend Section 50, Article XVI, Texas Constitution, by amending Subsections (a), (f), (g), and (t) and adding Subsection (f-1) that change provisions governing Texas Home Equity lending. If approved by the voters, SJR 60 will take effect January 1, 2018, and apply only to a home equity loan made on or after that date and to an existing home equity loan refinanced under SJR 60 on or after that date.

Major Changes

These proposed amendments will create major changes in Texas Home Equity lending by: (1) eliminating the ban on home equity loans on homesteads with agricultural exemptions; (2) reducing the 3% fee cap to a 2% fee cap with certain fees excluded from this 2% fee cap; (3) permitting, under certain conditions, a home equity loan to be refinanced as a non-home equity loan; (4) repealing the 50% ceiling on additional advances under a Home Equity Line of Credit (HELOC); (5) updating who is authorized to make home equity loans; and (6) amending the 12-day notice disclosure to reflect these changes, as more fully discussed below.

(1) SJR 60 proposes to repeal Subsection 50(a)(6)(I), the provision prohibiting home equity loans on property with an agricultural exemption other than dairy farms. This would eliminate a major risk factor for lenders making loans in rural areas as well as provide more options for borrowers.

(2) SJR 60 proposes significant modifications to the current 3% fee cap in Subsection 50(a)(6)(E). The fee cap would be reduced to a 2% fee cap, but the following fees would be excluded from this 2% fee cap: (i) an appraisal performed by a third party appraiser, (ii) a property survey by a state registered or licensed surveyor, (iii) a state base premium for a mortgagee policy of title insurance with endorsements established in accordance with state law, or (iv) if a mortgagee title policy is not issued, a title examination report if its cost is less than the state base premium for a mortgagee title policy without endorsements. The language in these proposed changes pose a few interpretative questions.

While the "third party" qualification for appraisals would exclude appraisals prepared by lender in-house appraisers, it is uncertain whether an appraiser employed by an affiliate of a lender would be a "third party." Additionally, it appears that the exclusion is only for the appraisal itself and other fees paid to a third party appraiser, such as an "appraisal management fee," would not be excluded from the 2% fee cap.

It is also important to note that the title company exclusions are restricted to the premium for the mortgagee policy and its endorsements (or the title report). Other services performed by a title company in connection with a home equity loan closing, such as settlement fees, notary fees, recording fees, etc. will not be exempt from the 2% fee cap. In addition, the nomenclature in the "mortgagee policy" exclusion does not match the nomenclature in the Texas Title Insurance Basic Manual for this type of title insurance policy, which could create future interpretative issues. Also, the endorsements exclusion raises the following questions. Is the exclusion limited to the required T-42 Equity Loan Mortgage Endorsement? Does the exclusion also include the permissible T-42.1 Supplemental Coverage Equity Loan Mortgage Endorsement? Would the exclusion include non-home equity endorsements required by the lender? New Home Equity Lending Interpretations jointly issued by the Finance Commission and Credit Union Commission, the financial regulatory agencies constitutionally and statutorily empowered to issue these interpretations, will have to answer these questions.

(3) Proposed Subsection 50(f)(2) of SJR 60 proposes to amend Subsection 50(f) to allow a home equity loan to be refinanced as a non-home equity refinance loan under Subsection 50(a)(4). Currently, a home equity loan made by the owner on the owner's current homestead may only be refinanced as another home equity loan or as a reverse mortgage (the "once an (a)(6), always an (a)(6)" rule). SJR 60 proposes the following conditions must be met in order for the owner to refinance the owner's home equity loan as a non-home equity refinance loan under Subsection 50(a)(4): (1) the refinance is not closed before the first anniversary of the date the home equity loan was closed; (2) no additional funds are advanced other than funds advanced to refinance a debt under Subsections 50(a)(1) through (a)(7) or actual costs and reserves required by the lender to refinance the debt; (3) the principal amount of the refinance when added to the aggregate total of the outstanding principal balances of all valid encumbrances of record against the homestead does not exceed 80% of the homestead's fair market value on the date of the refinance *(note that unlike Subsection 50(a)(6)(Q)(ix), SJR 60 does not propose a requirement that the owner and the lender sign a written acknowledgment of the fair market value of the homestead for a non-home equity refinance)*; and (4) the lender provides the owner the written notice prescribed by proposed Subsection 50 (f)(2)(D) of SJR 60 on a separate document within three business days of application and at least twelve days before the refinance is closed *(we presume that this 12-day period will be counted the same as for the 12th day for the notice prescribed by Subsection 50(g) - see Home Equity Lending Interpretation §153.12 – but this will have to be addressed by a new Home Equity Lending Interpretation)*. Proposed Subsection 50(f-1) of SJR 60 stipulates that the lien securing a refinance made in accordance with proposed Subsection 50(f)(2) "is deemed" to be a refinance lien under Subsection 50(a)(4) and also provides that an affidavit executed by the owner **or** the owner's spouse acknowledging that the above Subsection 50(f)(2) requirements were met "conclusively establishes" that the requirements of Subsection 50(a)(4) were met. It is noteworthy that a refinance of a home equity loan pursuant to proposed Subsection 50(f)(2) may be a recourse loan—a change from a home equity loan which is nonrecourse— and that the affidavit may be executed by either the owner or the owner's spouse. We recommend that this affidavit be a required closing document and that it always be executed by the owner and the owner's spouse.

This refinance provision creates a few interpretative questions. First, it is unclear whether this would apply only to closed-end home equity loans or if a HELOC could be refinanced under this provision. Second, it does not appear that there are any cure provisions if a

Subsection 50(f)(2) refinance does not meet all the requirements. A court could struggle with weighing an affidavit executed pursuant to Subsection 50(f-1) that "conclusively establishes" that the requirements have been met against clear evidence to the contrary (for example, a recent appraisal that shows LTV is over 80%). However, even if a failure to meet a Subsection 50(f)(2) requirement could invalidate a loan made under this provision, a lender would be protected by equitable subrogation in the amount of valid non-home equity loans paid off that were secured by the homestead. Also, does the Subsection 50(f-1) affidavit "conclusively establish" the validity of the Subsection 50(f)(2) refinance loan in the event the underlying home equity loan refinanced was void due to an uncured Subsection 50(a)(6) violation? If the answer is "no" and the underlying home equity loan remains uncured, the Subsection 50(f)(2) refinance loan will be void and all subsequent refinances that are based on it. As noted above, equitable subrogation could validate all or part of these loans.

Also of note, proposed Subsection 50(f)(2) contains confusing language that could require interpretation by the Finance Commission and Credit Union Commission. Proposed Subsection 50(f)(2)(B) likely contains a typographical error as it states "the *refinanced* extension of credit does not include the advance of any additional funds." It is likely this was intended to read "the *refinance of the* extension of credit . . . [.]" Proposed Subsection 50(f)(2)(B)(ii) also uses different language than the existing refinance provision in Subsection 50(e)(2) (*i.e.*, "the advance of all the additional funds is for reasonable costs necessary to refinance such debt …"). Proposed Subsection 50(f)(2)(B)(ii) states "actual costs and reserves required by the lender to refinance the debt …[.]" The Commissions may need to issue new Interpretations to address these language differences—*i.e.*, are "reasonable costs necessary to refinance such debt …" the same as or different from "actual costs and reserves required by the lender to refinance the debt … "?

Finally, and as discussed under **Implementation Issues**, we believe that the new 12-day notice mandated under proposed Subsection 50(f)(2)(D) could not be given until January 1, 2018, which would prevent any refinances of home equity loans under Subsection 50(f)(2) until January 13, 2018.

(4) With regard to a HELOC under Subsection 50(t), SJR 60 proposes to eliminate Subsection 50(t)(6) that prevents additional advances on a HELOC if the principal amount outstanding on the HELOC exceeds 50% of the fair market value of the homestead on the date the HELOC was established. The 80% fair market value cap under Subsection 50(a)(6)(K) is not affected by the repeal of Subsection 50(t)(6) and is reflected in the proposed revision to the Subsection 50(g) 12-day notice discussed below.

(5) SJR 60 clarifies and adds language regarding the entities and persons authorized to make home equity loans. Proposed Subsection 50(a)(6)(P)(i) states that subsidiaries of the enumerated banks, savings and loan associations, savings banks, and credit unions also may make home equity loans. Proposed Subsection 50(a)(6)(P)(vi) replaces the term "broker" with "banker or mortgage company," clarifying that licensed mortgage companies and registered mortgage bankers may make home equity loans.

(6) The last major change proposed by SJR 60 is to the 12-day notice in Subsection 50(g) in order to conform the notice language to the amended language in the proposed amendments

discussed in paragraphs (1), (2) and (4) above. As explained under **Implementation Issues**, the changes to this notice would create a window from January 1, 2018, to January 12, 2018, when home equity loans could not close.

Minor Changes
SJR 60 also proposes changes that codify established case law or make minor alterations in language. These include: (1) adding language to Subsection 50(a)(6)(E) that bona fide discount points used to buy down the interest rate are not fees (a codification of the Texas Supreme Court's holding in *Finance Commission of Texas v. Norwood*, 418 S.W.3d 566 (Tex. 2013)); (2) amending the language in Subsection 50(a)(6)(Q)(vi) by replacing "Section 50(a)(6), Article XVI, Texas Constitution" with "Subsection (a)(6) of this section"; and (3) deleting "or (I)" from the cure provisions in Subsection 50(a)(6)(Q)(x)(b), which would eliminate this agricultural use cure provision for home equity loans made in and after 2018—assuming SJR 60 is approved by Texas voters—because of SJR 60's prospective repeal of subsection 50(a)(6)(I).

Implementation Issues
The first implementation issue we foresee is that the SJR 60 proposed amendments to the language in the 12-day notice required by Subsection 50(g) would, in our view, create a twelve day window from January 1, 2018, to January 12, 2018, during which home equity loans could not close. This is based on our reading of the November 6, 1997, Texas Attorney General Opinion No. DM-452—issued just after passage of the amendment allowing home equity lending in Texas—that opined, in pertinent part regarding the 12-day notice, as follows:

> Before the amendment becomes effective … the provisions of the amendment referred to in the notice have no legal effect. Notice given before the effective date of the amendment is not notice "prescribed by" the amendment. Therefore, the amendment's notice requirement is not satisfied if notice is given before the effective date of the amendment, and thus the twelve-day waiting period is not triggered by such a notice.
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> **SUMMARY**
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> … [T]he notice to borrowers prescribed by the amendment is not effective if given before the amendment's effective date.

As the language of the current 12-day notice will be amended if SJR 60 is approved by the voters, and if the rationale in Attorney General Opinion DM-452 is applicable to the amended 12-day notice proposed by SJR 60, then it follows that:

- the current 12-day notice would not be effective if given in 2017 for a home equity loan closing in 2018, as it would not disclose the proper information; and
- the proposed amended 12-day notice would not be effective if given before January 1, 2018.

The second implementation issue we foresee is that the above reasoning likewise will apply to the 12-day notice in proposed Subsection 50(f)(2)(D) for non-home equity refinances of home equity loans, which also would not be effective if given before January 1, 2018.

To read and/or print the full text of SJR 60, click on this hyperlink or you may go to the Articles page of the firm's website www.bmandg.com and click on the June 15, 2017, Clients and Friends Memo that also discusses SJR 60, which has the text attached as a separate Addendum.

SENATE JOINT RESOLUTION NO. 1 (SJR 1)

SJR 1 proposes to amend Section 1-b, Article VIII, Texas Constitution, by adding Subsections (o) and (p) to provide for an exemption from ad valorem taxation of all or part of the market value of the residence homestead of the surviving spouse of a first responder who is killed or fatally injured in the line of duty if the surviving spouse has not remarried since the death of the first responder. SJR 1 authorizes the legislature to (i) define "first responder," (ii) prescribe additional eligibility requirements for the exemption and (iii) provide that the surviving spouse who subsequently qualifies a different property as the surviving spouse's residence homestead is entitled to an exemption from ad valorem taxation of the subsequently qualified homestead in an amount equal to the dollar amount of the exemption from ad valorem taxation of the first homestead in the last year in which the surviving spouse received the exemption if the surviving spouse has not remarried since the death of the first responder. If approved by the voters, this constitutional amendment will take effect January 1, 2018, and apply only to a tax year beginning on or after that date.

Senate Bill 15 (SB 15), the proposed enabling legislation for SJR 1, would add Section 11.134 to the Tax Code, and amend other sections of the Tax Code to conform with the new tax exemption, that, in pertinent part, defines "first responder" to mean an individual listed in Section 615.003 of the Texas Government Code, entitles the surviving spouse of a first responder who was killed or fatally injured in the line of duty to a property tax exemption of the full value of the surviving spouse's homestead if the spouse:

- was an eligible survivor for purposes of Chapter 615, Government Code, as determined by the Employees Retirement System of Texas; and
- had not remarried since the death of the first responder.

SB 15 provides that the tax exemption applies regardless of the date of the first responder's death and only to a tax year beginning on or after January 1, 2018. SB 15 takes effect January 1, 2018, contingent on voter approval of the constitutional amendment proposed by SJR 1.

HOUSE JOINT RESOLUTION NO. 21 (HJR 21)

HJR 21 proposes to amend Section 1-b(l), Article VIII, Texas Constitution, authorizing the legislature to provide for an exemption from ad valorem taxation of part of the market value of the residence homestead of a partially disabled veteran or the surviving spouse of a partially disabled veteran if the residence homestead was donated to the disabled veteran by a charitable organization for less than the market value of the residence homestead and harmonizing certain related provisions of the Texas Constitution. This allows the legislature to fix an anomaly in current law under which a partially disabled veteran whose residence homestead is donated in full by a charitable organization is entitled to this partial tax exemption, whereas a partially disabled veteran who paid part of the cost of a donated residence homestead currently receives no property tax exemption on its taxable value.

HB 150, the proposed enabling legislation for HJR 21, would amend Section 11.132(b) of the Tax Code to entitle a partially disabled veteran to a partial homestead exemption for a residence homestead that was donated at some cost to the veteran, as long that cost was no more than 50 percent of the good faith estimate of its market value as of the date the donation is made by the charitable organization. The partial tax exemption applies only to ad valorem taxes imposed for an ad valorem tax year that begins on or after January 1, 2018. HB 150 takes effect January 1, 2018, contingent on voter approval of the constitutional amendment proposed by HJR 21.

HOUSE JOINT RESOLUTION NO. 37 (HJR 37)

Section 47(a), Article III, Texas Constitution, requires the legislature to pass laws to prohibit lotteries and gift enterprises in the state, with certain exceptions that include bingo games and charitable raffles conducted by various nonprofit or religious organizations. HJR 37 proposes to amend Section 47 by adding Subsection (d-2) to read as follows:

> (d-2) Subsection (a) of this section does not prohibit the legislature from authorizing credit unions and other financial institutions to conduct, under the terms and conditions imposed by general law, promotional activities to promote savings in which prizes are awarded to one or more of the credit union's or financial institution's depositors selected by lot.

HB 471, the proposed enabling legislation for HJR 37, would amend the Finance Code by adding Chapter 280 (Texas Savings Promotion Act) to allow state and federal credit unions authorized to do business in this state and financial institutions (a bank, savings association, or savings bank maintaining an office, branch, or agency office in this state) to hold savings promotion raffles, where individuals could enter the raffle for a chance of winning a designated prize by depositing a specified amount of money in a savings account or other savings program. Accounts eligible for a savings promotion raffle would have to have certain characteristics commensurate with comparable accounts that were not eligible for the raffle—for example, fees, premiums, withdrawal limits, and interest or dividends would have to be commensurate with comparable accounts that were not eligible for the raffle. A credit union or financial institution could require a certain account balance for a certain period of time for the deposit to represent an entry in the raffle. The raffle would have to be conducted so that each entry has an equal probability of winning, and in a manner that does not jeopardize the ability of a credit union or financial institution to operate in a safe and sound manner or mislead the credit union's members or the financial institution's depositors, respectively.

HB 471 would prohibit credit unions and financial institutions from requiring consideration for participation in a savings promotion raffle and would specify that a deposit of the required amount of money in a savings account for entry in the raffle was not consideration. HB 471also would exempt savings promotion raffles from certain provisions in the Business and Commerce, Occupations, and Penal codes relating to sweepstakes by mail, charitable raffles, and gambling, respectively.

HB 471 would require credit unions and financial institutions that conduct savings promotion raffles to maintain all records that the Credit Union Commission or the Finance Commission, as applicable, determines are necessary for the appropriate financial regulatory authority to examine

these raffles. The Credit Union Commission and the Finance Commission of Texas would be required to adopt rules and procedures for the administration of Chapter 280.

HB 471 takes effect January 1, 2018, contingent on voter approval of the constitutional amendment proposed by HJR 37.

The above summaries are not complete descriptions of these proposed constitutional amendments and enabling legislative bills, and you are urged to review the entirety of any constitutional amendment or bill summarized above that you believe would affect your business. You may request copies from us, if you so desire.