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TO: Clients and Friends

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SUBJECT: Texas Home Equity Lending – 2013 Update

This memorandum will provide an overview of home equity lending embodied in Article XVI, Section 50, of the Texas Constitution and will also discuss some of the issues lenders face. The full text of Section 50, current to date, is attached to this memorandum (for ease of reference, the home equity and HELOC provisions are highlighted in bold typeface). All references to "sections," "subsections," and "parts" in this memorandum refer to the various provisions of Section 50, unless otherwise stated.

This 2013 update revises the May 19, 2010 memorandum as follows:

1. It adds the following new cases: *Bardwell v. Bank of New York as Trustee for Certificate Holder CWABS, Inc., Asset Backed Certificates Series 2006-26 Co.*, 2010 WL 3446915 (N.D.Tex. 2010); *In re Cadengo*, 370 B.R. 681 (Bankr.S.D.Tex. 2007); *Cerda v. 2004-EQR1 L.L.C.*, 612 F.3d 781 (5th Cir. 2010); *In re Erickson*, 2012 WL 4434740 (W.D.Tex. 2012); *In re Gulley*, 436 B.R. 878 (Bankr.N.D.Tex. 2010); *In re Harmon*, 444 B.R. 696 (Bankr.S.D.Tex. 2011); *Hawkins v. Wells Fargo Bank, N.A.*, 2012 WL 2376272 (W.D.Tex. 2012); *Modelist v. Deutsche Bank Nat. Trust Co.*, 2006 WL 2792196 (S.D.Tex. 2006); *Pennington v. HSBC Bank USA, N.A.*, 2012 WL 4513333 (5th Cir.(Tex.) 2012); *Penrod v. Bank of New York Mellon*, 824 F.Supp.2d 754 (S.D.Tex. 2011); *Poswalk v. GMAC Mortg., LLC*, 2012 WL 2193982 (N.D.Tex. 2012); *Priester v. JP Morgan Chase Bank, N.A.*, 2013 WL 539048 (5th Cir. 2013); *Puig v. Citibank, N.A.*, 2012 WL 1835721 (N.D.Tex. 2012); *In re Quigley*, 2011 WL 1045224 (Bankr.N.D.Tex. 2011); *Schanzle v. JPMC Specialty Mortg. LLC*, 2011 WL 832170 (Tex.App.-Austin 2011); *Sierra v. Ocwen Loan Servicing, LLC*, 2012 WL 527940 (S.D.Tex. 2012); *Sims v. Carrington Mortg. Services, LLC*, 2012 WL 3636884 (N.D.Tex. 2012); *Summers v. Ameriquest Mortg. Co.*, 2008 WL 123903 (Tex.App.-Hous. [14 Dist.] 2008); *Summers v. PennyMac Corp.*, 2012 WL 5944943 (N.D.Tex. 2012). For ease of reference, the name of each case identified above is highlighted in bold typeface (*see Section II. below*).
2. It makes editorial changes and typographical corrections to the existing text.

I. HOME EQUITY CONSTITUTIONAL AND INTERPRETATION AMENDMENTS

Since the home equity provisions were first added to the Constitution effective January 1, 1998, and the home equity interpretations ("Interpretations") were first adopted into the Administrative Code effective January 8, 2004 (*see* Section III.D.), both have been revised from time to time. In addition, new case law continues to clarify and interpret the constitutional home equity provisions. This memorandum attempts to incorporate these prior changes and present Texas home equity law as it currently exists. For these reasons, a proper understanding and application of home equity law and its

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interpretations may, and in some cases will, depend upon when a particular transaction closed or when the violation occurred.

II. LITIGATION
A. Three Percent Cap

Subsection 50(a)(6)(E) prohibits a home equity loan from requiring "*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. Hazard Insurance. *Doody v. Ameriquest Mortgage Co.*, 242 F.3d 286 (5th Cir. 2001), held that hazard insurance premiums do not count against the three percent fee cap mandated by subsection 50(a)(6)(E) because they do not constitute fees necessary to originate the home equity loan. In addition, the Fifth Circuit court certified two questions to the Texas Supreme Court on a related three percent fee cap violation issue, which is discussed in No. 2 below. Upon receiving the Texas Supreme Court's answer to the first certified question, the Fifth Circuit court in a per curiam opinion (see *Doody v. Ameriquest Mortg. Co.*, 263 F.3d 435 (5th Cir.) 2001)) vacated the district court's dismissal order and remanded with instructions to enter judgment for Ameriquest denying all relief sought by Doody.

2. Curing Three Percent Fee Violation. *Doody v. Ameriquest Mortgage Co.*, 49 S.W.3d 342 (Tex. 2001), involves the following two certified questions from the Fifth Circuit in the related *Doody* case discussed in No. 1 above, and one question from the plaintiff:

> <u>Certified Questions</u>: (1) Under the Texas Constitution, if a lender charges closing costs in excess of three percent, but later refunds the overcharge, bringing the charge costs within the range allowed by section 50(a)(6)(E), is the lien held by the lender invalid under section 50(c)?
>
> (2) If this question is reached, may the protections of section 50 of the Texas Constitution be waived by a buyer who accepts a refund of any overcharged amounts when the loan contract provides that accepting such refund waives any claims under section 50?
>
> <u>Plaintiffs' Question</u>: (3) If a loan made pursuant to section 50(a)(6) requires the borrower to pay, at the inception of the loan, premiums to insure the homestead from casualty loss, do these premiums constitute "fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit" under section 50(a)(6)(E)?

The Texas Supreme Court answered the first certified question favorably to lenders by permitting the lender to cure the violation within a reasonable time (*i.e.*, approximately three months after closing). In interpreting the pre-2003 non-specific cure provision of subsection 50(a)(6)(Q)(x) to permit a cure of the three percent fee cap violation, the Court also held that subsection 50(a)(6)(Q)(x) applied to all curable violations of subsection 50(a)(6). Because the court answered the first certified question "no," it was not necessary to answer the second certified question.

The Texas Supreme Court declined to answer plaintiffs' question regarding hazard insurance premiums because the Fifth Circuit had not certified that question to it, leaving open the possibility that if this issue is presented to the Texas Supreme Court in another case, the Court may decide this issue independent of the Fifth Circuit's *Doody* decision, *supra*, and of Interpretation §153.5(16) (*see Section III.D.1*).

The expanded cure provisions of subsections 50(a)(6)(Q)(x)(a) through (f) added by the 2003 amendments to subsection 50(a)(6)(Q)(x) [*see Section V.*] and the Texas Supreme Court *Doody* decision, *supra*, leave the following "cure" questions unanswered:

> (1) When does the cure period commence as to other loans when a lender is notified of a curable subsection 50(a)(6) violation in a specific loan, under circumstances in which the lender may reasonably presume that the same violation has occurred in other home equity loans of the lender?

(2) Excluding the specific cures enumerated in subsections 50(a)(6)(Q)(x) (a) through (e), are there "curable" violations to which the Texas Supreme Court *Doody* decision would still be applicable, or is the default cure provision of subsection 50(a)(6)(Q)(x)(f) the exclusive cure for these other violations?

(3) If there are other curable violations to which the Texas Supreme Court *Doody* decision still applies, what cure period is applicable – the 60-day limit in subsection 50(a)(6)(Q)(x) or a "reasonable time" determined by the court?

3. Fees as Interest. *Breaux v. United Companies Lending Corporation*, Civil Action No. H-99-3384 (S.D. Tex.–Houston Division, 2001), citing the Fifth Circuit *Doody* case, *supra*, held that hazard insurance premiums are not included in the three percent cap and that the tax service fee, processing fee, mortgage lender's fee, and lender loan fee, constitute "interest" under Texas law and, therefore, are not included in the three percent cap. The court held these fees were interest even though the court was aware the party receiving these fees was the originator and payee on the loan, but not the lender (*i.e.*, the defendant) who funded the loan. We disagree with the court's decision regarding the nature of these lender fees and, as this case does not establish legal precedent or a safe harbor for lenders, we strongly recommend that lenders continue to include these type of fees in the three percent cap until the Texas Supreme Court or a future amendment to subsection 50(a)(6) or a future Interpretation clarifies this issue. The court also concluded that the loan documents (which were standard Fannie Mae/Freddie Mac Texas Home Equity documents) did not impose personal liability on the plaintiffs and, on this issue, were consistent with the home equity requirements of the Texas Constitution.

4. Interest as a Fee. *Thomison v. Long Beach Mortgage Company*, 176 F.Supp.2d 714 (W.D. Tex.-Austin Division, 2001), held that a "loan origination fee" is a fee, not interest, and, thus, subject to the three percent fee cap. The court reasoned that since the lender referred to the origination point as a "fee", a fee it was. On appeal, the Fifth Circuit remanded the case back to the U.S. District Court where a take nothing judgment was entered and the prior opinion reported in 176 F.Supp.2d 714 was withdrawn (2002 WL 32138252 (W.D.Tex. 2002)). Although this opinion has been withdrawn, we mention it as a caution as to what could happen to lenders who denominate an interest charge as a "fee."

5. Discount Points. This section summarizes three cases deciding that discount points are interest and not fees subject to the three percent fee cap. We routinely recommend that lenders be cautious in allowing borrowers the option of buying down the interest rate by paying discount points, which have a combination fee and interest rate characteristic. Lenders should carefully document the rate and fee options offered to borrowers. When discount points are being paid, our home equity loan package includes a document the borrower signs electing to pay discount points in order to obtain a lower interest rate. This document should be used only when points are being paid to reduce the interest rate and not when the "discount points" include other fees. Central to the *Penrod v. Bank of New York Mellon* decision summarized in this section is a discount point election document similar to the one we use.

Whether the courts will take a broad or narrow interpretation of which "fees" are included in the three percent fee cap has only been partially answered. The Fifth Circuit *Doody* case, *supra*, excluded hazard insurance premiums from the three percent limitation, and the *Tarver, Cerda* and *Penrod* cases, *infra*, held "true" discount points are interest and not subject to the three percent limitation.

Tarver v. Sebring Capital Credit Corp., 69 S.W.3d 708 (Tex.App.-Waco, 2002, no pet.), involved discount points which the plaintiffs asserted are not interest but fees subject to the three percent fee cap. The appellate court affirmed the trial court's summary judgment decision; holding that true discount points are "interest", not subsection 50(a)(6)(E) "fees." On appeal, the plaintiffs raised for the first time the issue that if discount points are interest, then paying them up front violates subsection 50(a)(6)(L), which requires substantially equal monthly payments equal or exceeding accrued interest. As that issue was not raised at trial, the appellate court declined to address it as outside the scope of appellate review.

Accord, citing the *Tarver* case, *supra*, as authority: *Pelt v. U.S. Bank Trust National Association*, 2002 WL 31006139 (N.D. Tex.-Dallas Division 2002); *Grun v. Countrywide Home Loans,*

Inc., 2004 WL 1509088 (W.D. Tex.-San Antonio Division, 2004); *Marketic v. U.S. Bank National Assoc.*, 436 F.Supp.2d 842 (N.D. Tex.-Wichita Falls Division, 2006); *Maluski v. US Bank NA*, 2008 WL 5102013 (S.D. Tex.-Houston Division 2008), affirmed by Fifth Circuit in per curiam opinion (349 Fed.Appx. 971, 2009 WL 3403195), *infra* in No. 6); *McCallum v. Wells Fargo Bank, N.A.*, 2009 WL 3166070 (W.D. Tex.-Austin Division, 2009).

Cerda v. 2004-EQR1 L.L.C., 612 F.3d 781 (5th Cir. 2010). In this important Fifth Circuit decision, the court decided in favor of the lender on issues involving the three percent fee cap, substantially equal payments, and 12-day waiting period requirements of subsections 50(a)(6)(E), (L) and (O), and (M)(i), respectively. In making its decision, the Fifth Circuit court applied the version of the Texas Constitution that was in effect in 2002 when the home equity loan was made (home equity loan amendments do not apply retroactively, *see Fix v. Flagstar Bank, FSB,* infra in Section II.F.3.) and treated the Interpretations (*see* Section III.D.1.) only as persuasive authority (subsection 50(u)(1) provides that an Interpretation applies only if the Interpretation is in effect when the loan is made). The Fifth Circuit court addressed each of these home equity issues as follows:

• *50(a)(6)(E) Fee Cap:*

Discount Points. At closing, the lender received $11,025 as discount points, the mortgage broker received a $3,675 yield spread premium from the lender, and the plaintiffs received $4,827 as a lender credit. The court held that the discount points were interest that did not count against the three percent fee cap, relying upon the Waco appellate court *Tarver* decision, *supra*, and not the conflicting Austin appellate court *ACORN* decision, *infra* in Section II.H., because, as the court noted, it was without guidance from the Texas Supreme Court on this matter. The plaintiffs gave the following reasons why the discount points were fees subject to the three percent fee cap and not “true” discount points:

(1) it would be inconsistent for a lender to pay a yield spread premium on a loan with an above-market interest rate while simultaneously charging discount points that reduce the interest rate; and

(2) the lender credit - which was used to offset non-interest fees - was paid directly out of the discount points.

The court first addressed the plaintiffs’ arguments generally, stating that neither of the above reasons could overcome the district court's factual finding that the plaintiffs “have not shown by a preponderance of the evidence, or in fact by any evidence, that the [$11,025] paid by the [plaintiffs] in loan discount fees was not a legitimate discount point fee.” The court then addressed each reason specifically:

(1) In addressing the $3,675 yield spread premium, the court stated that it was not implausible that a yield spread premium and discount points could coexist within the same loan. The court conceded that a yield spread premium, as stipulated by the parties, is “a payment to the broker for selling a loan at an interest rate higher than market rates [,]” but stated that this definition does not preclude the borrower from reducing that interest rate by paying up-front discount points. Further, the court said there was nothing inherently illogical in a lender being willing to accept some of that interest in advance.

(2) With respect to the $4,827 lender credit, the court relied on its previous decision in the *Maluski* case, *infra* in No. 6, where it affirmed the grant of summary judgment to the lender. In *Maluski*, the defendant bank admitted that it lacked evidence of how the lender credit was applied. Maluski speculated that a portion of the credit could have been applied to interest charged at closing. The *Maluski* court stated that this unsubstantiated argument of how the credit theoretically could have been applied was insufficient to defeat summary judgment for the lender.

The court concluded by stating it accorded “the district court greater deference here because it sat as the trier of fact in a bench trial … and we discern no clear error in the district court's finding that the discount points were the legitimate prepayment of interest.” (***Note:*** *Until the Texas Supreme Court*

decides this issue in the ACORN appeal, in which the Supreme Court has granted review, we may continue to rely on the Tarver and *Cerda decisions.*)

Accord, following *Cerda* as authority: ***Bardwell v. Bank of New York as Trustee for Certificate Holder CWABS, Inc., Asset Backed Certificates Series 2006-26 Co.***, 2010 WL 3446915 (N.D.Tex. 2010); ***Poswalk v. GMAC Mortg., LLC***, 2012 WL 2193982 (N.D.Tex. 2012); ***Sierra v. Ocwen Loan Servicing, LLC***, 2012 WL 527940 (S.D.Tex. 2012).

Yield Spread Premium. At closing, the mortgage broker received a $3,675 yield spread premium from the lender. The court relied on its previous decision in the *Maluski* case, *infra* in No. 6, as persuasive in holding that the yield spread premium (*selling a loan at an interest rate higher than market rates*) paid to the mortgage broker by the lender did not count toward the three percent fee cap.

• *50(a)(6)(L) and (O) Substantially Equal Payments:* The loan provided for a variable interest rate with the following features: (i) start rate of 8.99% for the first two years; (ii) followed by semi-annually adjusted rate equal to the six-month LIBOR plus 7.1%; (iii) periodic rate caps of 1.5%; (iv) floor of 8.99%; and (v) lifetime cap of 15.99%. Acknowledging that some tension exists between subsection 50(a)(6)(L), which requires that periodic payments be substantially equal in amount, and subsection 50(a)(6)(O), which authorizes variable rates of interest, the court turned for guidance to the informal interpretations of these subsections in the Regulatory Commentary on Equity Lending Procedures (*see* Section III.D.1.) and the formal interpretations of these subsections in §§153.11 and 153.16, respectively, of the Interpretations, noting that the Regulatory Commentary and these Interpretations contain essentially the same construction. The court found the Regulatory Commentary and these Interpretations persuasive authority, in that their construction gives effect to both subsections, and held that the loan, by complying with the construction contained in the Regulatory Commentary and these Interpretations, did not in that regard violate subsection 50(a)(6).

• *50(a)(6)(M)(i) Waiting Period:* In this case, the plaintiffs applied by telephone for a $344,000 loan. The court held that the 12-day waiting period is triggered by an oral application, including a telephonic application. The court reasoned that because the term "application" in subsection 50(a)(6)(M)(i) is not restricted by the word "written," it encompasses oral applications, including telephonic applications. (***Note:*** *Interpretation §153.12(2), which states "[a] loan application may be given orally or electronically [,]" did not apply as it did not become effective until 2004, which was after the date of the home equity loan.*)

As stated above, the plaintiffs applied by telephone for a $344,000 loan, but ultimately they signed a loan application at closing for a $367,500 loan. Notwithstanding this discrepancy in loan amounts, the court agreed with the trial court's conclusion that the telephonic application "was part of the same loan transaction as the final loan for $367,500, and thus was sufficient to begin the 12-day period [,]" and held that the trial court's conclusion was not clearly erroneous. (***Note:*** *This holding by the court was based on the particular facts of this case and should not be presumed to apply in all cases in which the loan amount originally applied for changes.*)

Penrod v. Bank of New York Mellon, 824 F.Supp.2d 754 (S.D.Tex. 2011). Plaintiffs alleged the following section 50(a)(6) violations in the closing of their $88,000 home equity loan: (1) three percent fee cap violation under subsection 50(a)(6)(E); and (2) 80 percent fair market value violation under subsection 50(a)(6)(B).

•*Three Percent Fee Cap Violation:* Plaintiffs argued that the $4,400 in discount points they paid were not properly excluded from the three percent fee cap because of a fact question whether or not the discount points bought down the loan's interest rate. The court, without citing case authority or analyzing the law, held that the discount points were properly excluded from the three percent limit. In reaching this conclusion, the court relied exclusively on the Discount Point Acknowledgment the plaintiffs admitted they signed in order to induce the making of the loan, which read: *I acknowledge that I am electing to pay discount point(s) in this extension of credit transaction in order to obtain a lower interest rate. I acknowledge that I could have obtained a loan with fewer or no discount point(s), but that the loan would have had a correspondingly higher interest rate. I acknowledge that discount point(s) are "interest" under Texas law and that, accordingly, they are excluded from the 3% limit on*

fees [under Section 50(a)(6)(E)]. The court stated this "demonstrates that the discount points are properly excluded from the three percent limit."

•*80 Percent Fair Market Value Violation:* In support of their claim that at closing the loan violated the 80 percent fair market value limit, the plaintiffs proffered a printout from the Appraisal District that showed a lesser market value ($91,780) than as stated in the appraisal and in the Acknowledgment as to Fair Market Value signed by plaintiffs ($110,000). The court stated that the printout from the Appraisal District, even if properly authenticated, did not establish fair market value of the homestead as it is relevant to valuation for taxation purposes only, citing *Houston Lighting & Power Co. v. Fisher,* 559 S.W.2d 682, 686–87 (Tex.Civ.App.-Hou. [14th Dist.] 1977, writ ref'd n.r.e.). ("[I]t is generally held that the value placed upon real property for the purposes of taxation by assessment without participation of the landowner is not evidence of its value for purposes other than taxation. … [S]ince tax assessments rarely reflect the true market value.") The court held that the loan did not violate the 80 percent rule, basing its holding, without expressly stating it, on the appraisal and the Acknowledgment as to Fair Market Value signed by plaintiffs.

Accord as to fair market value issue, citing *Penrod* as authority, ***Poswalk v. GMAC Mortg., LLC*, 2012 WL 2193982 (N.D.Tex. 2012).**

6. Lender Credit/YSP. *Maluski v. US Bank NA*, 349 Fed.Appx. 971, 2009 WL 3403195 (5th Cir. 2009) involves a general closing cost credit given by the lender to the borrower at settlement and the payment of a yield spread premium (YSP) by the lender to the mortgage broker, and how they relate to a violation of the three percent fee cap.

The court held that the lender's general closing cost credit disclosed on the HUD-1 Settlement Statement, which was not disclosed as being applied to specific charge(s), reduced the total fees subject to the three percent fee cap disclosed on the HUD-1 Settlement Statement to the permitted three percent limit, even though the Bank lacked evidence of how the credit was applied and, as asserted by Maluski, the credit theoretically could have been applied to interest charged at closing.

See also, *McCallum v. Wells Fargo Bank, N.A.*, 2009 WL 3166070 (W.D. Tex.-Austin Division, 2009) in which the court held that fees subject to the three percent cap that were paid by the lender are not used in calculating the total fees subject to the three percent fee cap, citing the *Tarver* case, *supra* in No. 5, as authority (in *Tarver*, the lender had absorbed excess fees as a credit to comply with the three percent fee cap).

The court also held that the YSP paid to the mortgage broker by the lender is not included in the three percent fee cap because, although the lender may ultimately recoup the YSP over the life of the loan through the higher interest rate charged, "this indirect payment [of the YSP by the borrower] is not contemplated by a plain reading of the state constitution [subsection 50(a)(6)(E)]."

Accord, citing *Maluski* as authority*,* ***Cerda v. 2004-EQR1 L.L.C.***, 612 F.3d 781 (5th Cir. 2010), *supra* in No. 5.

Note: The Fifth Circuit has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in Fifth Circuit Rule 47.5.4.

B. Paying Off Unsecured Debt

Subsection 50(a)(6)(Q)(i) states, "*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. Debt to Another Lender. Prior to the 2003 amendments to the 12-day notice in subsection 50(g), the notice stated that the home equity loan "*must not require you to apply the proceeds to another debt that is not secured by your home or to another debt to the same lender*." This language difference between subsection 50(a)(6)(Q)(i) and the subsection 50(g) notice caused confusion regarding what unsecured debt the lender could require the owner to pay with home equity proceeds and was

addressed in the two cases summarized below, in which the plaintiffs alleged that they were improperly required to use equity loan proceeds to pay third-party unsecured creditors:

•*Stringer v. Cendant Mortgage Corp.*, 23 S.W.3d 353 (Tex. 2000), involved the following certified question from the U.S. Fifth Circuit to the Texas Supreme Court:

> *Under the Texas Constitution, may a home equity lender require the borrower to pay off third-party debt that is not secured by the homestead with the proceeds of the loan?*

The Texas Supreme Court answered the certified question in the affirmative, holding "that under the Texas Constitution, a home-equity lender may require a borrower to use loan proceeds to pay third-party debt that is not secured by the homestead." Based on this answer, in a per curiam opinion, 229 F.3d 466 (5th Cir.) 2000), the Fifth Circuit court dismissed the Stringers' appeal filed in *Stringer v. Cendant Mortgage Corp.*, 199 F.3d 190 (5th Cir. 1999).

•*McMahan v. Long Beach Mortgage Co.*, 235 F.3d 1340 (Table of Decisions Without Reported Opinions), 2000 WL 1672729 (5th Cir. 2000), unpublished opinion (No. 99-51001), held that the resolution of the language conflict between subsections 50(a)(6)(Q)(i) and 50(g) was controlled by the Texas Supreme Court's decision in the *Stringer* case, *supra*.

The 2003 amendments changed the 12-day notice language in subsection 50(g) to read as follows: "*not require you to apply the proceeds to another debt except a debt that is secured by your home or owed to another lender.*" This amended language finally resolved the language conflict between subsection 50(a)(6)(Q)(i) and the 12-day notice in subsection 50(g) and made moot the Texas Supreme Court's decision in *Stringer*, supra, and its accompanying recommendation that lenders add the *Stringer* court's drafted clarification language to the 12-day notice to resolve this discrepancy.

2. Debt to Same Lender. *Box v. First State Bank, Bremond S.S.B.*, 340 B.R. 782 (S.D. Tex.–Houston Division, 2006), involved the issue whether subsection 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 if the loan would not have been made unless the borrower agreed to this restricted use. At the bank's suggestion, plaintiffs obtained a home equity loan from the bank to repay an unsecured preexisting debt owed to the bank. Plaintiffs testified they voluntarily closed the loan to maintain a good relationship with the bank, hoping to obtain future loans. The bank testified it would not have made the loan if the proceeds had not been paid to the bank. The court concluded that the bank "required" the loan proceeds to be applied to its unsecured prior debt in violation of subsection 50(a)(6)(Q)(i) by conditioning approval of the loan on that basis, notwithstanding plaintiffs' voluntary consent to apply for the loan and to use the loan funds for that purpose. The court also held that the Interpretation in former §153.18(3) (*see **Our Comment** on §153.18 in Section III.D.1.*) did not apply because (i) the loan occurred before the Interpretations became effective, and (ii) the loan application could not be a "debt consolidation application" as there was only one debt to pay.

Chambers v. First United Bank & Trust Co., 419 B.R. 652, 2009 WL 3245420 (Bkrtcy.E.D.Tex.-Sherman Division 2009). The debtors were experiencing serious financial difficulties, as a result of which they were unable to make payments to the lender on their 1999 home equity loan and on a loan they guaranteed for purchase of their personal vehicles, and were unable to cure the overdrafts on a bank account they maintained with the lender. In 2004, at the suggestion of the lender and because the lender threatened to exercise its legal rights (including foreclosure of the 1999 home equity loan, legal action to collect the overdrafts, and repossession of the vehicles), the debtors refinanced the 1999 home equity loan with a bigger home equity loan from the lender in order to cure the above deficiencies. In this bankruptcy adversary proceeding, the debtors alleged that their 2004 home equity loan violated subsection 50(a)(6)(Q)(i), because part of the loan proceeds were used to pay the overdrafts on the bank account they maintained with the lender, and subsection 50(a)(6)(A), because their consent to the loan was not voluntary.

Subsection 50(a)(6)(Q)(i) prohibits a lender from requiring the borrower to apply home equity proceeds to pay non-homestead debt owed to the lender. While this claim, at first blush, appears to have some merit, the court summarily disposed of it on the facts, stating "the fact that the home equity loan satisfied the overdraft in the … account flowed naturally from the fact that the [debtors] used that

account [personally] as well as the fact that the account was materially overdrawn when the funds were deposited. The [debtors] could have, but did not, open a [new] bank account and demand that the proceeds of the home equity loan be placed in the new account."

Subsection 50(a)(6)(A) requires that a home equity loan be secured by a voluntary lien under a written agreement with the consent of the owner and the owner's spouse. Relying on Texas case law that a contract may be invalid or unenforceable due to economic duress where undue or unjust advantage has been taken of [the debtors'] economic necessity or distress to coerce [the debtors] into making the [loan], but that the economic duress must be based on the acts or conduct of the [lender] and not on the financial circumstances of the [debtor], the bankruptcy court held that the 2004 home equity loan was not the result of coercion, fraud, or undue influence by the lender. As the court stated, "[I]f the Court were to follow the [debtors'] reasoning, no Texas homeowner would be able to refinance his current home loan if that loan was in default."

*(**Note:** This bankruptcy decision has no precedential value, but, in our opinion, it is persuasive as applied the facts of this case.)*

C. Agricultural Use Designation

1. *LaSalle Bank National Assoc. v. White*, 217 S.W.3d 573 (Tex.App.-San Antonio, 2006 pet. granted), involved a home equity loan secured by a homestead that at closing was designated for agricultural use under Texas Tax Code, chapter 23, subchapter D (*i.e.*, open-space land). Subsection 50(a)(6)(I) prohibits homestead property designated for agricultural use (*except primarily for the production of milk*) as provided by statutes governing property tax from securing a home equity loan. Plaintiff did not use the property for milk production. The bank argued that subsection 50(a)(6)(I) applies only to land designated for agricultural use under Texas Tax Code, chapter 23, subchapter C (*i.e.*, agricultural use as owner's primary occupation and primary source of income). The appellate court stated, "[h]*ad the drafters of article XVI, section 50(a)(6)(I) intended for that section to apply only to land on which agriculture is the owner's primary occupation and primary source of income, they could have so limited the article's language. Because article XVI, section 50(a)(6)(I) contains no such limitation, we conclude that article XVI, section 50(a)(6)(I) … refers to land put to an agricultural use as defined by, and assessed for tax purposes under, both subchapter C and subchapter D of the Tax Code.*"

2. *Marketic v. U.S. Bank National Assoc.*, Civil Action No. 7:05-CV-131-R (N.D. Tex.–Wichita Falls Division, 2007), involved an interpretation of pre-2007 amended subsection 50(a)(6)(I). When plaintiff's home equity loan closed, the homestead was not subject to an agricultural use designation under the property tax statutes (plaintiff removed it at the request of the originating lender). At the time the bank (to whom the loan was sold) attempted to foreclose on the defaulted loan, plaintiff had re-designated the homestead for agricultural use under the property tax statutes. In an interim Memorandum Opinion and Order (reported in 436 F.Supp.2d 842), the court found that plaintiff's homestead, if subsequently re-designated for agricultural use, is protected from forced sale under subsection 50(a)(6)(I) regardless of how the homestead was designated when the home equity loan closed. In its Final Judgment, however, and based on a settlement agreement between the parties, the court held that the bank's deed of trust created a valid lien on the homestead and permitted the bank to foreclose on the loan. Based on the court's interpretation of subsection 50(a)(6)(I) as it then existed, subsection 50(a)(6)(I) was amended in 2007 to limit subsection 50(a)(6)(I)'s applicability to the "date of closing." Although we believe the court's interpretation of subsection 50(a)(6)(I) was misguided, the potential danger of this case is in the facts that resulted in this decision (*i.e.*, closing a home equity loan on homestead on which an agricultural use designation is removed prior to closing for the sole purpose of making the home equity loan and then reinstated after closing). Under these facts, we are uncertain that the 2007 amendment to subsection 50(a)(6)(I) would protect a lender.

D. Equitable Subrogation

1. *Langston v. GMAC Mortgage Corp.*, 183 S.W.3d 479 (Tex.App.-Eastland, 2005, no pet.), involved a divorce proceeding in which the court applied the doctrine of equitable subrogation to preserve what would have been an invalid home equity lien. Prior to the divorce, Langston and his wife closed on a home equity loan secured by Langston's separate real property. In the divorce, the trial court improperly awarded Langston's separate property to the wife. The wife then refinanced the home

equity loan with a home equity loan from GMAC. The appellate court reversed the property award to the wife and reinstated Langston in title. GMAC sought a declaration that its lien was enforceable against the property under the doctrine of equitable subrogation even though Langston did not execute a security instrument in favor of GMAC. Under the doctrine of equitable subrogation, a third party who pays a debt at the request of the debtor may be subrogated to the prior creditor's security interest for the debt that has been discharged. The doctrine's purpose is to prevent unjust enrichment of the debtor who owed the debt that is paid. The doctrine requires that the third party payor not be a volunteer but be required to make payment either under a legal obligation, an agreement for subrogation, or to protect its rights or property. The appellate court held that because GMAC paid off the prior home equity loan at the request of one of the debtors (the wife) and Langston befitted from GMAC's loan (it extinguished a prior lien on his separate property) GMAC was not a volunteer.

2. *LaSalle Bank National Assoc. v. White*, 246 S.W.3d 616 (Tex. 2007, rehearing denied 2008), involved a home equity loan (subsequently assigned to the bank) secured by a lien against a 10-acre homestead that was designated for agricultural use. Subsection 50(a)(6)(I) prohibits agricultural use designated homestead from being used as security for a home equity loan (*see appellate decision in LaSalle, supra, Section II.C.1.)*. Portions of the home equity loan proceeds were used to pay off a purchase money lien and outstanding property taxes against the tract. Plaintiff received the remaining balance (less closing costs) as equity proceeds. In a significant decision for Texas lenders, the Texas Supreme Court held the lender was equitably subrogated to the prior lienholders' purchase money and tax liens, thereby reversing, in part, the appellate decision in the *LaSalle* case discussed in Section II.C.1.

The court's decision was based on the applicability of section 50(e), which states:

> 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.

The bank argued that it was equitably subrogated to the liens held by the third parties who were paid the balance of the existing purchase money and ad valorem tax debts. The Texas Supreme Court, citing a long history of judicial decisions, stated, "Texas has long recognized a lienholder's common law right to equitable subrogation. … [t]he doctrine allows a third party who discharges a lien upon the property of another to step into the original lienholder's shoes and assume the lienholder's right to the security interest against the debtor … [and] … has been repeatedly applied to preserve lien rights on homestead property."

The court further stated, "Section 50(e) contains no language that would indicate displacement of equitable common law remedies was intended, and we decline to engraft such a prohibition onto the constitutional language. LaSalle's equitable subrogation claim does not derive from its contractually refinanced debt and accompanying lien, for which section 50(e) mandates forfeiture. Instead, LaSalle's claim arises in equity from its prior discharge of constitutionally valid purchase-money and tax liens. By definition, equitable remedies apply only when there is no remedy at law, and the legal forfeiture that article [section] 50(e) imposes does not destroy the well-established principle of equitable subrogation." Citing its decision in *Benchmark Bank. v. Crowder,* 919 S.W.2d 657 (Tex. 1996), the court further stated, "[o]nce valid, the lien does not become invalid against the homestead simply because the original debt has been refinanced."

One interesting aspect of this case is that the court went all the way back to 1890 to find an invalid home equity case (home equity loans were not permitted in Texas until 1998) upholding equitable subrogation to the extent of the prior valid purchase money lien that the invalid home equity loan had paid off. See, *Texas Land & Loan Co. v. Blalock*, 13 S.W. 12 (Tex. 1890).

In summary, a void home equity loan that refinances valid homestead debt will benefit from equitable subrogation to preserve the lien and debt as to those funds advanced to pay off preexisting valid

homestead debt. But, equitable subrogation will not validate the home equity proceeds (*i.e.*, that portion of the loan proceeds not used to refinance prior valid liens).

See also, citing the Texas Supreme Court decision in the *LaSalle Bank* case*, supra*, as authority: *Johnson v. National City Mortgage Co.*, 2009 WL 2982783, 62 Collier Bankr.Cas.2d 1380 (Bkrtcy.E.D.Tex.-Sherman Division 2009) in which the court applied the doctrine of equitable subrogation to an invalidly made home equity loan that had paid off a pre-existing valid purchase money loan; *In re Harmon*, 444 B.R. 696 (Bankr.S.D.Tex. 2011), *infra* in Section II.K.1.

3. *AMC Mortgage Services, Inc. v. Watts*, 260 S.W.3d 582 (Tex.App.-Dallas, 2008, no pet.), involved a superiority of lien and title dispute, in which the court denied Ameriquest Mortgage Company's ("Ameriquest") equitable subrogation to the first lien purchase money loan paid off with the proceeds of Ameriquest's home equity loan because the home equity loan documents did not specifically mention that the home equity loan proceeds paid off the prior lien. The following sequence of events is important in understanding this case:

(1) In 1996 Gonzalez purchased the property with a first lien purchase money loan from Long Beach Mortgage and a second lien purchase money loan from Smith (the seller), which provided that it was subordinate to the Long Beach loan.

(2) In 1999 Gonzalez refinanced the Long Beach loan with a loan from Ameriquest that contained renewal and extension language for the Long Beach loan. Ameriquest filed a release of lien for the Long Beach loan.

(3) In 2000 and, again, in 2003, Gonzalez obtain a home equity loan from Ameriquest. The 2000 home equity loan paid off Ameriquest's 1999 renewal and extension loan, but did not contain renewal and extension language for the 1999 loan. Ameriquest filed a release of lien for the 1999 renewal and extension loan. Ameriquest's 2003 home equity loan paid off the 2000 home equity loan for which Ameriquest filed a release of lien. The 2003 home equity loan did not contain any renewal and extension language for the 2000 home equity loan that was paid off.

(4) Both the 2000 and the 2003 home equity deeds of trust contained a subrogation provision subrogating the lender to all prior rights, superior title, and liens regardless whether they were assigned to the lender or released.

(5) In 2004 Gonzalez defaulted on the Smith loan, and the property was foreclosed and sold to the foreclosing lender.

(6) In May 2005 Watts purchased the property with a loan from Argent Mortgage. In December 2005 Ameriquest foreclosed on its 2003 home equity loan.

Watts asserted that the 1996 Smith deed of trust (under which Watts took title after foreclosure) was superior to the 2003 home equity deed of trust, while Ameriquest asserted that both the 2000 and 2003 deeds of trust (although later in time) are superior under the doctrine of equitable subrogation because the 2000 and 2003 home equity loans paid off and, thus, were subrogated to the 1996 first lien Long Beach loan.

Citing prior case authority that (i) a good faith purchaser will prevail over the holder of a prior equitable title and (ii) a party claiming title through equitable principles has the burden of proving that a subsequent legal titleholder is not a good faith purchaser, the court held that even if the 2003 loan was equitably subrogated to the Long Beach loan, it will not prevail against Watts' title because Watts is a good faith purchaser of the property. According to the court and the prior case authority on which it relied, a good faith purchaser is a person who demonstrates "that the purchase was made (1) in good faith, (2) for valuable consideration, and (3) without actual or constructive knowledge of any outstanding claims of a third party." Watts is a good faith purchaser, in part, said the court because Watts had no actual or constructive knowledge of the 2003 loan's superior claim as nothing in the documents filed in the real estate records indicated that the Long Beach loan was paid with the

proceeds of the 2000 and 2003 loans. On the contrary, the records reflect that the Long Beach loan was released. Thus, the 1996 Smith deed of trust appeared to become the superior lien because the 2000 and 2003 deeds of trust were later in time and as they did not appear from the records to relate to the 1999 Ameriquest refinance deed of trust, but appeared to be inferior to the Smith deed of trust, when the Smith deed of trust was foreclosed, the apparently inferior, later in time, 2003 deed of trust appeared to be extinguished; thus, nothing in the records gave Watts actual or constructive notice that the 2003 deed of trust was not extinguished by the foreclosure of the Smith deed of trust or that equitable subrogation made the 2003 deed of trust superior to the Smith deed of trust.

This case highlights the importance of obtaining a subordination of an inferior lien when the equity loan will discharge a loan of higher lien priority and, if possible, a transfer of the prior lien securing the loan being paid off.

4. *In re Gulley*, 436 B.R. 878 (Bankr.N.D.Tex. 2010). In this adversary proceeding, the bankruptcy court held that the lender must forfeit all principal and interest under the home equity loan, in addition to not having a valid lien, because the non-borrowing spouse did not consent to the home equity loan at closing, in accordance with subsection 50(a)(6)(A), or subsequent to closing, in accordance with the cure provision of subsection 50(a)(6)(Q)(xi), which states, in pertinent part, that "the lender or any holder of the note … shall forfeit all principal and interest … if … the [home equity] 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[.]"

But, under the theory of equitable subrogation, the court also held that the lender was entitled to a secured claim secured by a lien against the homestead to the extent it had paid the ad valorem property taxes on the homestead, citing the Texas Supreme Court *LaSalle Bank* decision, *supra* in No.2., as authority that the lender was equitably subrogated to these tax liens.

*(**Note:** This bankruptcy decision has no precedential value, but it correctly applies the forfeiture provisions of subsection 50(a)(6)(Q)(xi) and the equitable subrogation decision of LaSalle Bank.*)

E. Estoppel

1. *Sosa v. Long Beach Mortgage Co.*, No. 03-06-00326-CV (Tex.App.-Austin, 2007), is an appeal to overturn a foreclosure of a home equity lien on the Sosa homestead on the basis that that only a portion of the property foreclosed on was Sosas' homestead (there appeared to be some limited evidence that one of the houses was leased to a third party, but the timing was unclear) and, thus, the loan violated subsection 50(a)(6)(H), which prohibits a home equity loan from being secured by additional collateral. The Sosas owed a lot containing two houses and claimed a homestead exemption on the entire lot for the tax years 1995 through 2002. In 2001, the Sosas obtained a home equity loan from Long Beach evidenced by a security instrument granting a lien on the entire lot and other loan documents that reflected the entire lot was designated as their homestead. When the Sosas defaulted, Long Beach foreclosed on the property and the Sosas sued for wrongful foreclosure. Long Beach asserted that because the Sosas claimed the entire lot as their homestead with the tax authority as well as in the home equity loan documents, the Sosas are estopped from taking a contrary position. One who asserts the affirmative defense of estoppel must conclusively prove: (1) a false representation or concealment of material facts; (2) made with the knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; and (5) who detrimentally relies on the representations. Because the Sosas (i) represented to Long Beach that the entire property was their homestead, and (ii) claimed a homestead exemption on the entire property in loan instruments and to tax authorities, and (iii) because Long Beach relied on the Sosas' representations and sworn affidavits to make a home equity loan secured by the purported homestead, the appellate court concluded the Sosas were estopped from claiming that the loan violated the constitution (*i.e.*, subsection 50(a)(6)(H)).

2. *In re Cadengo*, 370 B.R. 681 (Bankr.S.D.Tex. 2007). This adversary proceeding involved a home equity loan disguised as a sale transaction. Without getting into the lengthy and convoluted facts, the court held that the debtor had equitable title when the loan was closed because her parents' divorce decree required them to convey the homestead property to the debtor once she reached 18 years of

age, which the parents failed to do. At the time of closing in December 2010 the debtor was 19 years old and had permanently and continuously resided at the homestead property since 1993.The court found that because the debtor had an equitable title on the date of the transaction (the court found that the divorce decree gave her equitable title once she was 18 years old), she was entitled to homestead protection. The court found this to be true despite the fact that she signed documents at the closing falsely stating that the property was not her homestead and that she resided elsewhere. The court found that the lender was not entitled to the protection afforded by Section 50(d) ("… 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 … encumbered is not the homestead of the affiant.") because (i) the lender had actual knowledge the debtor resided at the property and was aware of the terms of the divorce decree, whereby the debtor obtained an equitable interest in the property upon turning 18; and (ii) even if the lender was without actual knowledge, the debtor's actual use and possession of the property imputed such actual knowledge to the lender. The court held that under subsection 50(d) "a lender may rely upon a non-homestead affidavit only if it is without knowledge of the borrower's right to claim a homestead and the borrower is not in actual use and possession of the property."

Next, looking to the intent of the parties in making its determination, the court found that the transaction was a home equity loan notwithstanding the fact that the closing documents were structured as a sale. And, finally, having determined that the transaction was a home equity loan, the court found several violations of subsection 50(a)(6), and because the lender's 60-day window to cure under subsection 50(a)(6)(Q)(x) had expired (the court held that the 60-day window began on July 17, 2006, when the debtor's adversary proceeding Complaint was filed), the court held that the lender must forfeit the entire principal and interest including disgorging the payments already made by the debtor.

(***Note:*** *This bankruptcy decision has no precedential value, but it is persuasive on the homestead issues addressed and the forfeiture provisions of subsection 50(a)(6)(Q)(x).*)

3. *Summers v. PennyMac Corp.*, 2012 WL 5944943 (N.D.Tex. 2012). In this suit plaintiffs alleged that the principal amount of the note exceeded 80 percent of the fair market value of the homestead on the date of the note in violation of subsection 50(a)(6)(B). The court held that the plaintiffs' allegation failed as a matter of law because at closing plaintiffs had signed a Home Equity Affidavit, incorporated in their pleadings by reference, swearing under oath that the principal amount of the note did not exceed 80 percent of the fair market value of the homestead on the date of the note. *See* also the ***Penrod v. Bank of New York Mellon*** case, *supra* in Section II.A.5, in which the court held that the 80 percent requirement of subsection 50(a)(6)(B) was not violated because the plaintiffs had signed an Acknowledgment as to Fair Market Value required by subsection 50(a)(6)(Q)(ix)), supported by an appraisal that complied with subsection 50(h), stating a fair market value within the 80 percent limit.

F. Home Equity Cure

1. Failure to Notify. *Curry v. Bank of America, N.A.*, 232 S.W.3d 345 (Tex.App.-Dallas, 2007, review denied 2008), involved a home equity loan that closed at the Currys' place of business, which was not a location authorized by subsection 50(a)(6)(N). Prior to filing suit, the Currys notified the bank by letter that the loan did not comply with section 50(a), but did not specify the violation. The Currys filed suit and again alleged generally that the loan did not comply with the home equity provisions of the constitution but did not specify how. After the bank independently determined the loan did not close at an authorized location and offered to cure the violation by refinancing the loan pursuant to subsection 50(a)(6)(Q)(x)(f), the Currys asserted, for the first time, specific violations – failure to close at a required location, failure to receive a copy of all documents signed by the Currys relating to the loan, the inclusion of a prepayment penalty and an improper acceleration clause in the loan documents. The key issue in this case is whether the Currys properly notified the bank of its home equity violations. The appellate court determined that the Currys did not properly notify the bank of the violations because the Currys did not describe how the loan was non-compliant. Although not controlling because it became effective after the suit was filed, the court favorably mentioned Interpretation §153.91 (*see Section III.D.3.*), which provides that notice is adequate under the cure provision of subsection 50(a)(6)(Q)(x) if it "include[s] a reasonable description of the alleged failure to comply."

2. Methods of Notification. ***Puig v. Citibank, N.A***., 2012 WL 1835721 (N.D.Tex. 2012). Plaintiffs alleged several section 50(a)(6) violations in the closing of their home equity loan, which the court decided against the plaintiffs on the facts. This case is included because it discusses Interpretation §153.93 (*see* Section III.D.3.). Defendant claimed the plaintiffs did not provide the notice of failure to comply required by subsection 50(a)(6)(Q)(x); specifically, that plaintiffs failed to give notice in accordance with the terms set forth in the Deed of Trust, which required notice of noncompliance be given by first class mail to the lender's address (*§153.93(a) permits a lender, at closing, to designate in writing the location where the borrower may deliver a notice of violation*). Relying on §153.93(f), which provides that if the borrower uses another location or method of delivery "the borrower has the burden of proving that the location and method of delivery were reasonably calculated to put the lender or holder on notice of the default," the court stated that plaintiffs had met the burden in §153.93(f) by the filing and serving of a lawsuit that described specific violations of section 50(a)(6). This decision was affirmed by the Fifth Circuit in *Puig v. Citibank, N.A.,* 2013 WL 657676 (5th Cir. 2013) (***Note:*** *The Fifth Circuit has determined that its opinion should not be published and is not precedent except under the limited circumstances set forth in Fifth Circuit Rule 47.5.4.*).

3. Specific Cure Provisions - Retroactive Effect. *Fix v. Flagstar Bank*, *FSB*, 242 S.W.3d 147 (Tex.App.-Ft. Worth, 2007, review denied 2008), involved the bank's January 2003 conventional refinance of the Fixes' home equity loan. At that time, subsection 50(a)(6)(Q)(x) did not contain specific cure provisions for curing a home equity loan defect or set a time limit on when a cure must be tendered. (*See Section V. for the specific home equity loan cure provisions.*) In February 2004, the Fixes notified the bank by letter that the refinance loan violated Section 50(a)(6) because it: (i) was closed within one year of the closing of the home equity loan, and (ii) allowed for personal liability and non-judicial foreclosure. Within 21 days of receipt of the letter, the bank sent the Fixes a letter offering to cure these violations with a refinance home equity loan in accordance with the specific cure requirements of subsection 50(a)(6)(Q)(x)(f). The Fixes refused the offer and brought this suit to compel forfeiture of all principal and interest under the loan. In September 2003, prior to the time the Fixes notified the bank of the violations and the bank notified the Fixes of its offer to cure these violations, subsection 50(a)(6)(Q)(x) was amended to provide for specific cure provisions and change the "reasonable time" to cure to a 60-day time period. The court stated that the question presented by this case was whether the 2003 amendment to subsection 50(a)(6)(Q)(x) retroactively applied to the bank's offer to cure the constitutional defects in the refinance loan, which was executed before the amendment was passed. The court declined to retroactively apply the 2003 amendment to subsection 50(a)(6)(Q)(x) and, instead, applied the pre-2003 amendment version of subsection 50(a)(6)(Q)(x). Relying upon the Texas Supreme Court's *Doody* decision, *supra* in Section II.A.2., and also citing *Adams v. Ameriquest Mortgage Co.*, 307 B.R. 549 (Bkrtcy. N.D.Tex. 2004), *infra* in this No. 3, the court held that the offer to cure occurred "*within a reasonable time*" as stated in the pre-2003 amendment version of subsection 50(a)(6)(Q)(x). And, applying the pre-2003 amendment version of subsection 50(a)(6)(Q)(x), the court also held that the bank's offer to cure constituted a sufficient offer to cure the constitutional defects in the refinance loan.

Summers v. Ameriquest Mortgage Co., 2008 WL 123903 (Tex.App.-Houston [14 Dist.] 2008) applies the *Doody* decision, *supra* in Section II.A.2., to the issue of whether a temporal violation under section 50(a)(6) can be cured by the pre-2003 amendment version of the cure provision in subsection 50(a)(6)(Q)(x). This case involves a March 2003 home equity loan that closed less than one year after a prior home equity loan closed. Defendant offered to cure the violation by crediting plaintiff's account with $1000 and offering her the right to refinance the loan under the same terms, modified as necessary to comply with section 50(a)(6), but plaintiff rejected the offer. Citing the *Doody* decision and the decision in *Adams v. Ameriquest Mortgage Co.*, 307 B.R. 549 (Bkrtcy. N.D.Tex. 2004), *infra* in this No. 3, the court stated, "[t]he *Doody* court's pronouncement that the cure provision applies to all of section 50(a)(6) would necessarily include [section 50(a)(6)(M)(iii)'s] requirement that two home equity loans must not close within one year. Thus, [plaintiff's] argument that the temporal defect could never be cured must fail." The court further noted that the subsection 50(a)(6)(Q)(x)(f) cure offered by defendant provided additional support for the court's above conclusion; reasoning that although subsection 50(a)(6)(Q)(x)(f)'s amendment (eff. Sept. 2003) to subsection 50(a)(6)(Q)(x) occurred after the time of the offer and, thus, was not applicable in this case, the court agreed with the prior decisions in *Adams* and in *Fix*, supra, that the amendment clarified already existing rights under the pre-2003 amendment version of subsection 50(a)(6)((Q)(x) and stated that this conclusion is consistent with the Supreme

Court's holding in *Doody* that "section 50(a)(6)(Q)(x)'s cure provision applies to all the lender's obligations under the extension of credit."

Adams v. Ameriquest Mortgage Co., 307 B.R. 549 (Bkrtcy. N.D.Tex. 2004), is a pre-2003 amendment case in which the lender refinanced a home equity loan with a loan not documented as a home equity loan because the lender did not intend to close the refinance loan as a home equity loan. Section 50(f) requires that a refinance of a home equity loan must also be a home equity loan. The lender wanted to cure the home equity defects in the refinance loan pursuant to the specific cure provisions of subsection 50(a)(6)(Q)(x) added by the 2003 amendment. Among the defects to be cured were violations of the following subsection 50(a)(6) requirements: (1) 80% fair market value limitation; (2) no personal liability; (3) foreclosure by court order; (4) required notices; (5) home equity disclosure in security instrument; and (6) fair market value acknowledgment. Relying on the holding in the *Doody* decision*, supra* in Section II.A.2., the court held that subsection 50(a)(6)(Q)(x) could be used to cure all the home equity defects in the loan (even though the lender had no intention of making a home equity loan), by the lender offering to redo the transaction. The court stated that the expanded cure provision in the 2003 amendment to subsection 50(a)(6)(Q)(x) was a clarification of already existing lender cure rights and is consistent with the holding in *Doody,* Id. The court further stated, "[t]*he borrower may not refuse to comply with a reasonable offer to cure by the lender. Such a holding would allow the borrower to effectively block the lender's power to cure in many instances.*" This bankruptcy decision has no precedential value, but it is persuasive on the issue of the lender's right to cure under pre– and post-2003 amended subsection 50(a)(6)(Q)(x) without the borrower's compliance, particularly the "refinance cure" in subsection 50(a)(6)(Q)(x)(f) that allows a lender to cure defects in home equity loans, even timing requirement defects, that are not curable any other way.

4. Savings Clause. *Foster v. Bank One Texas N.A.*, 54 Fed.Appx. 592, 2002 WL 31730405 (5th Cir. 2002) involved a 1998 home equity loan secured by plaintiff's Austin residence comprising 1.75 acres (*in 1998 the Texas Constitution limited urban homesteads to one acre*) and certain personal property situated thereon. The plaintiff asserted the loan violated subsection 50(a)(6)(H) (*which prohibits equity loans being secured by any real or personal property other than the borrower's homestead*). While acknowledging that this additional collateral would constitute a violation of subsection 50(a)(6)(H), the Fifth Circuit court used the savings clause in the home equity security instrument to affirm the trial court's judgment denying plaintiff's claim. The savings clause stated, in pertinent part, "notwithstanding any provision of this Homestead Lien Contract to the contrary in no event shall this Homestead Lien Contract require or permit any action which would be prohibited by Section 50(a)(6), Art. XVI, Texas Constitution, and all provisions of this Homestead Lien Contract shall be modified to comply fully with Section 50(a)(6), Art. XVI, Texas Constitution." The court stated that this savings clause automatically cured any defect under subsection 50(a)(6)(H).

The 1998 loan was subsequently renewed in 2000 and 2001, which loans omitted the personal property security provision that was in the 1998 loan. Also, in 1999 the Texas Constitution was amended to increase the urban homestead to ten acres. For these reasons, the Fifth Circuit court stated in regard to these two loans "when the 2000 lien and promissory note renewed and extended the 1998 loan, any defect in the 1998 lien was remedied. *See Thompson v. Chrysler First Bus. Credit Corp.,* 840 S.W.2d 25, 29 (Tex.App.Dallas 1992, no writ) ('In Texas, the execution of an 'extension agreement' pertaining to an outstanding debt is generally treated as a new contract evidencing the existing debt.')."

Note: The Fifth Circuit has determined that the *Foster* opinion should not be published and is not precedent except under the limited circumstances set forth in Fifth Circuit Rule 47.5.4.

Accord, citing the *Foster* case, *supra*, as authority, *Chambers v. First United Bank & Trust Co.*, *supra* in Section II.B.2.

5. Cure Letter Failure. *Agredano v. Wells Fargo Financial Texas, Inc.* (Bkrtcy. W.D. Tex.-San Antonio Div., 2003), was a bankruptcy adversary proceeding involving the pre-2003 cure provisions of subsection 50(a)(6)(Q)(x). The plaintiffs notified Wells Fargo that their home equity loan was not in compliance with subsection 50(a)(6) because the loan documents provided for personal liability and non-judicial foreclosure without court order. Although the note stated that the loan was ***the type of***

credit defined by section 50(a)(6) and also quoted the home equity conditions of subsection 50(a)(6)(Q), it did not contain the non-recourse and court order foreclosure restrictions of subsections 50(a)(6)(C) and (D). In fact, the note stated that *each person is fully and personally obligated … to pay in full the amount owed.* The deed of trust did contain the subsection 50(a)(6)(Q)(vi) disclosure that the loan is the type of credit defined by subsection 50(a)(6), but it provided for a non-judicial power of sale and no subsection 50(a)(6) restrictions were stated. Wells Fargo's reply letter to the plaintiffs stated that (i) the promissory note states that the loan was *the type of credit defined by section 50(a)(6), Article XVI of the Texas Constitution*; (ii) this section of the Constitution provides that the loan is without recourse for personal liability and can only be foreclosed by judicial foreclosure; and (iii) the loan was subject to the restrictions mentioned in their [Wells Fargo] letter. The essential question was whether Wells Fargo's letter cured the defects noted in the plaintiffs' letter within the meaning of the pre-2003 cure provisions of subsection 50(a)(6)(Q)(x). In a Memorandum Decision, the bankruptcy court found that: (1) Wells Fargo's lien was invalid from its inception because the note and deed of trust contained personal recourse and nonjudicial foreclosure provisions in violation of subsections 50(a)(6)(C) and (D); (2) the disclosures in the note and the deed of trust that the loan was the type of credit defined by subsection 50(a)(6) conflict with these express personal liability and nonjudicial foreclosure provisions; (3) Wells Fargo's response letter failed to cure these defects within the meaning of subsection 50(a)(6)(Q)(x) because it failed to expressly repudiate or remove these impermissible provisions; and (4) because of lien invalidity and the failure to cure, Wells Fargo is not entitled to equitable subrogation for that part of the loan proceeds used to pay off first lien indebtedness against the homestead. The court noted that Wells Fargo's letter could have *clearly and unequivocally* cured the defects by stating that the offending note and deed of trust provisions were of no further force and effect. Later, the court dismissed the adversary proceeding with prejudice, withdrew its prior Memorandum Decision, and granted a compromise application filed by the parties pursuant to a confidential settlement agreement filed with the court. While this case does not establish legal precedent, it does point out the danger of "cure" letters that do not *clearly and unequivocally* cure the defect.

See also, ***In re Erickson***, 2012 WL 4434740 (W.D.Tex. 2012), *infra* in Section II.G.2., in which the court held the lender cured the violation in accordance with subsection 50(a)(6)(Q)(x) by providing Erickson with timely written notice that it waived and renounced any right or claim to pursue personal recourse against him.

G. Miscellaneous Cases

1. No Loan. *Alcorn v. Washington Mutual Bank, F.A.*, 111 S.W.3d 264 (Tex.App.–Texarkana, 2003), is interesting only because the bank spent $17,962.55 in attorney's fees and considerable time defending against plaintiffs' frivolous claim "that, legally, the home equity note did not represent a loan … to them, but instead represented money that was 'created' for their own account by their signatures, so the money represented by the note was theirs from the beginning and [the lender] owed the money to them instead of their owing it to the mortgage company." After receiving the loan proceeds, plaintiffs stopped making note payments and the bank attempted to foreclose its lien. Based on the above spurious claim, the plaintiffs sued to stop the foreclosure. The appellate court upheld summary judgment for the bank.

2. Only Debt. ***In re Erickson***, 2012 WL 4434740 (W.D.Tex. 2012). This appeal to the district court arose out of a bankruptcy adversary proceeding filed by Erickson, the bankruptcy debtor, against Wells Fargo, the current holder and beneficiary of Erickson's August 9, 2002 home equity note and deed of trust, respectively, alleging the following home equity constitutional violations:

(1) Erickson alleged that the Wells Fargo's home equity loan violated subsection 50(a)(6)(K), which requires a home equity loan to be "the only debt secured by the homestead at the time the [home equity loan] 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." Erickson argued that because on the date of Wells Fargo's loan there were loans secured by the homestead that were not made for any purposes authorized by subsections (a)(1)-(a)(5) or subsection (a)(8), that these loans must be paid off before a new home equity loan on his homestead could be made. The court held that there was no violation of subsection 50(a)(6)(K), explaining that because the proceeds of Wells Fargo's loan were used to pay

off these prior loans Wells Fargo's loan was the "the only debt secured by the homestead at the time the [home equity loan was] made."

(2) Erickson alleged that because the deed of trust did not expressly grant Wells Fargo a right of judicial foreclosure, it violated subsection 50(a)(6)(D), which requires a home equity loan to be "secured by a lien that may be foreclosed upon only by a court order." The court held that it is not necessary for the deed of trust to expressly grant the right to judicial disclosure for Wells Fargo to have the authority to pursue this remedy, explaining that under Texas law judicial foreclosure is a judicial remedy independent of the parties' contract [the deed of trust].

(3) Erickson alleged that because the deed of trust made him personally liable for amounts accruing under the loan, it violated subsection 50(a)(6)(C), which requires a home equity loan to be "without recourse for personal liability." Although not reaching this issue on the merits because it was not considered by the bankruptcy court, the district court noted that even if Erickson's allegation has merit, Wells Fargo cured the violation in accordance with subsection 50(a)(6)(Q)(x) by providing Erickson with timely written notice that it waived and renounced any right or claim to pursue personal recourse against him.

3. Non-forfeiture. *Vincent v. Bank of America, N.A.*, 109 S.W.3d 856 (Tex.App.-Dallas, 2003, review denied 2004), involved a post-closing dispute regarding the bank's allocation of the loan payments between principal and interest. The plaintiffs sought forfeiture of all principal and interest on the loan pursuant to the pre-2003 cure provisions of subsection 50(a)(6)(Q)(x). Citing the *Stringer* case, *supra* in Section II.B.1., as authority, the court held that "*forfeiture is only available for violations of constitutionally mandated provisions of the loan documents. Violation of any other provision of the loan documents may result in traditional breach of contract causes of action only, with traditional breach of contract remedies. Therefore, the Vincents were only entitled to forfeiture if the Bank breached a provision of the Loan Agreement that was constitutionally mandated. … Because* [the Loan Agreement paragraph complained of by the Vincents] *is not constitutionally mandated, its breach will not support forfeiture.*" Although, in our opinion, the court's premise is correct, the troubling part of this decision is that the facts stated in the court's opinion show that the bank did breach a constitutionally mandated provision of the Loan Agreement (*i.e.*, the requirement of subsection 50(a)(6)(L) that each monthly payment equal or exceed the amount of accrued interest). According to the opinion, the way in which the bank allocated the monthly payments resulted in interest accruing for several months in excess of the scheduled monthly payment called for in the loan documents. It remains to be seen how the reasoning in this opinion will hold up in light of the 2003 amendments to subsection 50(a)(6)(Q)(x) and the subsequently issued Interpretations discussed in Section III. D. below.

Accord, citing the *Vincent* case, *supra*, as authority: *Chambers v. First United Bank & Trust Co.*, *supra* in Section II.B.2; ***Modelist v. Deutsche Bank Nat. Trust Co***., 2006 WL 2792196 (S.D.Tex. Aug. 2006) (*The court can find no case law in support of Plaintiff's theory that a violation of any law* [other than breach of home equity requirements] *triggers the forfeiture provision of Article XVI, Section 50(a)(6), of the Texas Constitution.*), Magistrate's Memorandum and Recommendation Adopted in Part by *Modelist v. Vestal* [same case], 2006 WL 2792197 (S.D.Tex. Sept. 2006).

4. Copies of Signed Documents. *Pelt v. U.S. Bank Trust National Association*, 359 F.3d 764 (5th Cir. 2004), involved the pre-2007 amended subsection 50(a)(6)(Q)(v) requirement that the lender provide the borrower with copies of all documents "signed by the owner" related to the home equity loan. The plaintiffs asserted that, in violation of subsection 50(a)(6)(Q)(v), they received copies of unsigned documents not copies of signed documents. The Fifth Circuit court held that subsection 50(a)(6)(Q)(v) does not require that the owner be provided a signed copy of each document. The phrase "signed by the owner" only identifies which documents must be copied and provided to the owner. It does not require that the documents be photocopied only after they have been signed.

Note: Due to the 2007 amendment to Section 50(a)(6)(Q)(v), this interpretation by the Fifth Circuit is no longer correct (*see revised Interpretation §153.22 in Section III. D.1*).

5. Four Year Statute of Limitations: These cases concern the applicability of the four-year residual limitations period codified in Section 16.051 of the Texas Civil Practice and Remedies Code as a bar to

recovery on an action brought for violations of the home equity requirements in section 50(a)(6). Section 16.051 of the Texas Civil Practice and Remedies Code states, "Every action for which there is no express limitations period, except an action for the recovery of real property, must be brought not later than four years after the day the cause of action accrues."

Rivera v. Countrywide Home Loans, Inc., 262 S.W.3d 834 (Tex.App.-Dallas, 2008, no. pet.) applied the residual four-year statute of limitations to a subsection 50(a)(6)(B) violation (80% fair market value requirement). Apparently, the appraisal for the home equity loan overstated the value of the homestead and caused Countrywide to loan in excess of 80% of its fair market value. The parties agreed that the four-year statute of limitations applied to this cause of action but disagreed on the cause of action's accrual date *(i.e.*, when the four-year statute of limitations began to run). Countrywide asserted the accrual date is either the date of closing (September 28, 2001) or the date of the overstated appraisal (September 1, 2001). The Riveras asserted the accrual date is the date of the final installment on the loan or, in the event of foreclosure, the date of acceleration of the loan. Section 50(a)(6) does not define the accrual date for violations of its provisions, so the court was charged with the responsibility of determining the accrual date for a violation of subsection 50(a)(6)(B). The court stated that "[t]he general rule governing the accrual of a claim for purposes of limitations [when not defined by statute or the Constitution] is the 'legal injury rule,' which states that a claim accrues 'when a wrongful act causes some legal injury, even if the fact of injury is not discovered until later, and even if all resulting damages have not yet occurred'." The court stated the legal injury in this case occurred when Countrywide made the home equity loan in excess of the amount allowed by law (*i.e.*, the closing date of September 28, 2001). Because the Riveras did not file this suit until March 31, 2006 (more than four years after the closing date), the court held their claim was barred by the four-year statute of limitations. Finally, the court held that the Riveras did not timely plead the discovery rule or the doctrine of fraudulent concealment, so they could not assert them to defeat Countrywide's limitations defense. (In a footnote to the decision, the court stated "[w]e make no comment whether the discovery rule or fraudulent concealment doctrine would have applied if either had been properly asserted.")

Accord, citing the *Rivera* case, *supra*, as authority, ***Schanzle v. JPMC Specialty Mortg. LLC***, 2011 WL 832170 (Tex.App.-Austin 2011).

Priester v. JP Morgan Chase Bank, N.A., 708 F.3d 667, 2013 WL 539048 (5th Cir. 2013) involves a November 2005 home equity loan. Plaintiffs alleged that the closing of the loan occurred in their home in violation of subsection 50(a)(6)(N) and that they did not receive the 12-day notice in violation of subsection 50(a)(6)(M)(i). Plaintiffs notified the original lender, Long Beach Mortgage Company, and the present holder, JP Morgan Chase Bank, of these violations by letters dated July 2010 and August 2010, respectively. Neither Long Beach nor Chase took action to cure the violations as required by subsection 50(a)(6)(Q)(x). In October 2010, plaintiffs sued in state court for declaratory judgment that their home equity loan and lien were void *ab initio* and that defendants failed to cure the constitutional violations and, therefore, were required to forfeit all principal and interest on the loan. Chase subsequently removed the case to federal court and moved to dismiss the suit as time-barred under the residual four-year statute of limitations (*Tex. Civ. Prac. & Rem. Code, §16.051*). The magistrate judge recommended that Chase's motion to dismiss be granted, and the district court adopted the magistrate judge's recommendation and dismissed the suit, on the basis that Chase's affirmative defense of limitation bars plaintiffs' suit (see*, Priester v. Long Beach Mortg. Co., 2011 WL 6116491 (E.D.Tex. Oct. 2011); Report and Recommendation Adopted by Priester v. Long Beach Mortg. Co., 2011 WL 6116481 (E.D.Tex. Dec. 2011)*). On appeal the Fifth Circuit court held:

- Liens created in violation of section 50(a)(6) are voidable rather than void;
- A limitations period applies to constitutional deficiencies under section 50(a)(6);
- The applicable limitations period is the residual four-year limitations period under §16.051, Tex. Civ. Prac. & Rem. Code;
- The "legal injury" rule (and not the "discovery rule") applies to such claims of constitutional violations and, therefore, begins to run at loan closing;
- Lenders' failure to provide the required 12-day notice did not constitute fraudulent concealment that would result in a tolling of the limitations period;
- Because a violation of section 50(a)(6) renders a lien voidable rather than void, once the limitations period has passed, the lien is no longer voidable and is valid.

6. Foreclosure. *Wilson v. Aames Capital Corp.*, 2007 WL 3072054 (Tex.App-Houston [14 Dist.] 2007 no pet.) is a home equity foreclosure case in which Wilson asserted that Aames, as the party seeking to foreclose a home equity lien on Wilson's homestead, had the burden to prove that the lien satisfied all the home equity requirements of subsections 50(a)(6)(A)-(Q). In a memorandum opinion, the appellate court held that judicial economy dictates that the lender's failure to comply with the home equity requirements of section 50(a)(6) is an affirmative defense to be raised by the homestead owner.

Accord, citing the *Wilson* case, *supra*, *Chambers v. First United Bank & Trust Co.*, *supra* in Section II.B.2.

Burney v. Citigroup Global Markets Realty Corp., 244 S.W.3d 900 (Tex.App.-Dallas, 2008), involved the issue of when the four-year statute of limitations begins to run on a home equity loan in default. The court correctly noted that: (i) under Tex. Civ. Prac. & Rem. Code §16.035(a), a four-year statute of limitations applies to a suit to foreclose on a real property lien; (ii) the statute of limitations begins to run from an installment note's maturity date or the date of its acceleration; and (iii) acceleration of a note requires clear and unequivocal notice of intent to accelerate and notice of acceleration. Under the facts of this case, the borrower received a notice of intent to accelerate (October 18, 1999) but no specific notice of acceleration was sent to the borrower. On April 5, 2000, the original lender filed an application for expedited foreclosure proceedings (which was later dismissed for want of prosecution) and notified the borrower of its filing. The court held that: (1) the lender's notice to the borrower of the filing of the application constituted notice of acceleration and, thus, acceleration of the loan occurred on April 5, 2000, "thereby triggering the running of the four-year statute of limitations[;]" and (2) as the present lender's foreclosure action did not commence until November 2004, it was barred because it was outside the four-year statute of limitations period.

Note: Although the court did state that the note was accelerated on April 5, 2000, from other statements in the opinion it is unclear the exact date the running of the statute of limitations commenced. Was it the date the notice of the filing of the application for expedited foreclosure proceedings was sent to the borrower (*not stated in the opinion, but presumably sometime in April 2000*) or the date the application was filed (April 5, 2000)? Since the dates were apparently so close together, it did not affect the court's decision.

7. Arbitration Agreement. *Galvan v. Centex Home Equity Co., L.L.C.*, 2008 WL 441773 (Tex.App.-San Antonio, 2008, no. pet.) involved a pre-2003 home equity loan that was subject to an arbitration agreement. This case is included, not because it sheds any new light on home equity law, but because it gives a good discussion of the limits placed on a court reviewing an arbitration award pursuant to an arbitration agreement subject to the Federal Arbitration Act. In essence, a court's review is very limited.

8. Unauthorized Lender. *In re Quigley*, 2011 WL 1045224 (Bankr.N.D.Tex. 2011). In this adversary proceeding, the bankruptcy court held that pursuant to subsection 50(a)(6)(Q)(xi) a holder of a home equity loan forfeits all principal and interest on the loan if the lender who made the loan is not a person authorized under subsection 50(a)(6)(P) to make home equity loans. Mood Shadow Investments (the note holder by assignment from Quigley, the originating lender) asserted a good faith purchaser for value status as a defense against the application of subsection 50(a)(6)(Q)(xi) to it. Applying a straight forward reading of subsection 50(a)(6)(Q)(xi), which states, in pertinent part, that "***any holder*** of the note … shall forfeit all principal and interest … if the [home equity loan] is made by a person other than a person described under [subsection 50(a)(6)(P)]," [emphasis added] the court held that subsection 50(a)(6)(Q)(xi) applies to a note holder of a home equity loan regardless of its status as holder.

In a footnote to its decision, the court stated that Moon Shadow was not without a remedy. Because Quigley endorsed the note without recourse when he assigned it, Moon Shadow could recover under the note from Quigley.

(***Note:*** *This bankruptcy decision has no precedential value, but, in our opinion, it correctly applies the forfeiture provisions of subsection 50(a)(6)(Q)(xi).*)

H. Cases Attacking Home Equity Interpretations

ACORN v. Finance Commission of Texas and Credit Union Commission of Texas, 303 S.W.3d 404 (Tex.App.-Austin, 2010, review granted 2011). In January 2004, ACORN (*i.e.*, Association of Community Organizations for Reform Now) and several "nominal" individual plaintiffs brought suit in the 126th District Court, Travis County, Texas, Cause No. D-1-GN-04-000269, alleging certain Home Equity Interpretations jointly adopted by the Finance Commission and Credit Union Commission to be unconstitutional.

On April 29, 2006, the District Court ordered that the following Interpretations are invalid: §§153.1(11); 153.5(3), (4), (6), (8), (9), and (12); 153.12(2) (invalid as to orally submitted applications, and not invalid as to electronically submitted applications); 153.13(4); 153.18(3); 153.20; 153.22; and 153.84(1). (*Interpretations §§153.13, 153.18, 153.20, 153.22 and 153.84 were subsequently revised.*)

In an opinion issued January 8, 2010, the Austin appellate court reversed that portion of the District Court's judgment invalidating Interpretations §§153.12(2), 153.22, and 153.84(1) and affirmed the remainder of the District Court's judgment appealed, which included affirming that portion of the District Court's judgment invalidating Interpretations §§153.1(11) and 153.5(3). These two Interpretations define interest for home equity purposes - §153.1(11) for home equity purposes generally, and §153.5(3) specifically for the three percent fee cap imposed by subsection 50(a)(6)(E):

1. Interpretation §153.1(11) defines interest to be "interest as defined in the Texas Finance Code §301.002(4) [sic] and as interpreted by the courts." (***Note:*** *Section 301.002(a)(4), in pertinent part, defines interest as "compensation for the use, forbearance, or detention of money."*)

2. Interpretation §153.5(3) defines interest as "[c]harges 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."

The appellate court's decision affirming the invalidity of §§153.1(11) and 153.5(3) is causing much concern in the lending community because these definitions are the basis for excluding bona fide discount points from the three percent fee cap. Some are questioning whether this decision invalidating §§153.1(11) and 153.5(3) now require a bona fide discount point to be included in the three percent fee cap. We conclude from our analysis of the appellate court's opinion that it does not hold that discount point(s) are included in the three percent fee cap, for the following reasons:

1. In endnote 10 of the opinion, the appellate court writes, "we are not in the position to provide a substitute definition of interest or to definitively categorize 'discount points' … as either 'interest' or 'fees.' "

2. The section of the opinion affirming the invalidity of §153.1(11) is principally based on the court's reasoning that Section 301.002(a)(4) of the Finance Code is a definition of interest for usury purposes only. This is in conflict with *Tarver*, 69 S.W.3d at 712-713, *supra* in Section II.A.5, which holds that discount point(s) are interest for the purposes of the three percent fee cap, basing its decision, in part, on Section 301.002(a)(4) and certain administrative rules that refer to this definition of interest.

3. In the *Stringer* case, *supra* in Section II.B.1, in which the Texas Supreme Court decided a home equity constitutional issue unrelated to the three percent fee cap, the court's opinion cited with approval the *Regulatory Commentary on Equity Lending Procedures* issued October 7, 1998, by the Office of Consumer Credit Commissioner, the Department of Banking, the Savings and Loan Department (now named the Department of Savings and Mortgage Lending), and the Credit Union Department; stating that the *Commentary* supported the court's holding, *Stringer*, 23 S.W.3d at 357. The *Tarver* opinion, noting the *Stringer* court's approval of the *Commentary*, for that reason also used the *Commentary* as a basis for its decision holding that discount point(s) are interest for purposes of the three percent fee cap. The *Commentary* is a precursor to the Interpretations (which were not adopted until 2004, after the *Stringer* and *Tarver* cases were decided) and contains language almost identical to the definition of interest in §153.1(11).

Based on the above, and the subsequent Fifth Circuit *Cerda* decision, *supra* in Section II.A.5, approving *Tarver*, we believe that until a decision by the Texas Supreme Court, or a constitutional amendment, settles this issue, lenders who fund home equity loans may continue to rely on the *Tarver* and *Cerda* decisions as authority for treating bona fide and reasonable discount point(s) as interest for the purposes of the three percent fee cap mandated by subsection 50(a)(6)(E).

Note: *On January 29, 2010, the Austin appellate court notified all parties that the court's May 24, 2006 stay order remains in place, and on February 25, 2011, the Texas Supreme Court granted a petition for review of the Austin appellate court's decision. This means that the Interpretations declared to be invalid remain in effect until all appellate remedies have been exhausted and the Texas Supreme Court issues its decision. Until such time, lenders may continue to close home equity loans without regard to the Austin appellate court's January 8, 2010 decision.*

I. Adjustable Rate Home Equity Loans

1. *Morehouse v. Ameriquest Mortgage Company*, Cause No. 9:05-CV-75 (E.D. Tex.–Lufkin Division, 2005) is a federal class action lawsuit that seeks declaratory, injunctive and equitable relief on behalf of a class of persons who made adjustable rate home equity loans during the period January 1, 1998 to December 31, 2003, during which period there were no Interpretations (*see §153.16 in Section III.D.*). The suit alleges that the adjustable rate home equity loans of the class members originated during this time period are invalid because subsection 50(a)(6)(L) requires substantially equal successive monthly installments and the promissory notes vary the amount of the monthly installments due to the adjustable interest rate feature of the notes. Plaintiffs assert that adjustable rate home equity loans should provide for an extended duration of the note in order for the payments to remain substantially equal rather than allow for payment adjustments, and that it was the intent of the drafters of subsection 50(a)(6) to allow lenders this flexibility. The case is still pending.

(***Note:*** *On March 17, 2010, in the companion federal class action case, Trahan v. Long Beach Mortgage Company and Washington Mutual Bank, F.A., Cause No. 9:05-CV-29 (E.D. Tex.–Lufkin Division, 2005), the court entered an order of dismissal with prejudice.*)

2. ***Cerda v. 2004-EQR1 L.L.C.***, *supra* in Section II.A.5, is a Fifth Circuit decision in which the court reconciled the tension between subsection 50(a)(6)(L), which requires that periodic payments be substantially equal in amount, and subsection 50(a)(6)(O), which authorizes variable rates of interest, by turning for guidance to the informal interpretations of these subsections in the Regulatory Commentary on Equity Lending Procedures (*see* Section III.D.1.) and the formal interpretations of these subsections in Interpretations §§153.11 and 153.16, noting that the Regulatory Commentary and these Interpretations contain essentially the same construction. The court found the Regulatory Commentary and these Interpretations persuasive authority, in that their construction gives effect to both subsections, and held that the loan, by complying with the construction contained in the Regulatory Commentary and these Interpretations, did not in that regard violate subsection 50(a)(6).

3. *McCallum v. Wells Fargo Bank*, *N.A*., 2009 WL 3166070 (W.D. Tex.-Austin Division, 2009) is a case in which the McCallums claimed that their adjustable rate home equity loan violated the subsection 50(a)(6)(L) requirement that payments must be "in substantially equal successive periodic installments." The court's opinion did not explain or quote the text of the adjustable rate feature of the loan; but, after referring to the District Court *Cerda* case*, infra* in No. 4*,* (which had similar facts, not disputed by the McCallums, and which was affirmed by the Fifth Circuit *Cerda* case, *supra* in No. 2), the court held that the loan did not violate subsection 50(a)(6)(L). Finally, in response to the McCallums assertion that the note called for a balloon payment, the court held that the fact that the interest rate could rise to nearly double its initial rate over a period of time does not constitute a balloon payment.

(***Note:*** *It is not clear from the court's opinion if the McCallums were asserting two separate subsection 50(a)(6)(L) violations – the variable payment feature and the balloon payment – or only subsection 50(a)(6)(L)'s balloon payment prohibition.*)

4. *Pelt v. U.S. Bank Trust National Association*, 2002 WL 31006139 (N.D. Tex.-Dallas Division 2002) involved the Pelts' claim that their home equity loan violated subsection 50(a)(6)(L)'s substantially

equal payment requirement because they paid $12,000 in discount points at closing, which amount was not substantially equal to the $2,150 monthly installment called for in the note. The court interpreted subsection 50(a)(6)(L) to apply only to repayment of a loan, not prepayments (*e.g.*, Pelts' discount points paid at closing), and, thus, subsection 50(a)(6)(L) does not require discount points (which are a prepayment of interest) to be substantially equal to the scheduled periodic payments.

Accord, *Cerda v. 2004-EQR1, LLC*, Civil Action No. SA-07-CV-632-XR (W.D. Tex.-San Antonio Division, 2009), citing the *Pelt* case, *supra*, as authority.

J. Home Equity Loan Modifications

1. *Pennington v. HSBC Bank USA, N.A.*, 493 Fed.Appx. 548, 2012 WL 4513333 (5th Cir. 2012), *Certiorari Denied*, 133 S.Ct. 1272, 81 USLW 3369, 81 USLW 3445, 81 USLW 3452 (U.S. Feb. 19, 2013) (NO. 12-768), holds that a Trial Period Plan ("TPP") under the federal Home Affordable Modification Program ("HAMP") in connection with plaintiffs' request for a modification of their home equity loan is not a modification when the plaintiffs fail to meet the conditions the TPP specifies are necessary to obtain a modification. As one of the conditions to obtaining a loan modification, the TPP established a schedule of payments, which were less than the payments required to cover all the principal and interest owed on the home equity loan with each installment. After paying ten trial payments under the TPP, plaintiffs were denied a modification by defendant. The Fifth Circuit court affirmed the district court's dismissal of plaintiffs' claims. See, *Pennington v. HSBC Bank USA, Nat. Ass'n*, 2011 WL 6739609 (W.D.Tex. 2011) ("*Nor does the fact that the Defendants accepted partial payments during the TPP trial mean that they violated the Texas Constitution. Although the partial payments constituted less than the accrued interest and paid off no principal, these were plainly temporary payments to stave off foreclosure, and were not themselves an extension of credit contemplated by Section 50(a)(6)(L). … The scheduled loan payments were not changed by the TPP, which provides that [the bank] will "hold the payments received during the Trial Period in a non-interest bearing account until they total an amount that is enough to pay my oldest delinquent monthly payment on my loan in full."*")

(***Note:*** *The Fifth Circuit has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5th Cir. R. 47.5.4.*)

2. *Sims v. Carrington Mortg. Services, LLC*, 889 F.Supp.2d 883, 2012 WL 3636884 (N.D.Tex. 2012). In this putative class action, the plaintiffs alleged that the 2009 and 2011 modifications of their delinquent 2003 home equity loan violated various requirements of subsection 50(a)(6) and other requirements in section 50 relating to home equity lending, based on the fact that the modifications capitalized and added past due interest to the principal of the loan. In a decision highly beneficial to homeowners and lenders desiring to modify delinquent home equity loans, the court dismissed with prejudice all claims and causes of action brought by the plaintiffs, as summarized below:

• *Refinance vs. Modification:* The plaintiffs asserted that the modifications were, in effect, refinances and not modifications. The definition of "modification" in §153.14(2) of the home equity Interpretations (*see* Section III.D.1.) states that "[a] modification of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced." The court held that the plain language of the modification documents showed no intention to satisfy and replace the original note, which caused these transactions to fall within the §153.14(2) definition of "modification."

• *Capitalized Past Due Interest:* The plaintiffs asserted that capitalizing past due interest and adding that amount to the loan's principal was the advancement of additional funds prohibited in the modification of a home equity loan by §153.14(2)(B) of the Interpretations (*The advance of additional funds to a borrower is not permitted by modification of an equity loan.*). The court interpreted the additional funds prohibition of §153.14(2)(B) as contemplating money provided by the lender to the borrower over and above the amount already loaned, which the borrower could use for other purposes at the borrower's discretion. Plaintiffs also relied on the Texas financial agencies April 2009 Home Equity Modification Advisory Bulletin, which they claimed "endorsed" certain methods for modifying home equity loans. The court stated that while the Bulletin (which applies the repayment schedule

requirements of subsection 50(a)(6)(L) to a permissible modification) may have persuasive value, it does not bear the weight of the home equity Interpretations and does not prohibit the use of any other lawful modification method, including the capitalized-past-due-interest method used by the defendant in the modification of plaintiffs' loan.

• *80 Percent Fair Market Value:* The plaintiffs asserted that the modifications violated the 80 percent fair market value limit of subsection 50(a)(6)(B) because the loan amount in each modification exceeded this 80 percent limit due to the capitalized interest. Plaintiffs contented that defendant was required to abide by the 80 percent limit for each modification. The court held that the 80 percent fair market value limit applies only on the date on which the borrower obtained the original home equity loan. In reaching this holding, the court interpreted the phrase "on the date the extension of credit is made" in subsection 50(a)(6)(B) and its accompanying Interpretation §153.3 to refer only to the date of the original home equity loan and not the date of each subsequent modification, and that the defendant was required to consider the 80 percent fair market value limit only on the date the plaintiffs obtained the original home equity loan. As additional support for its holding, the court also interpreted the parenthetical exception in §153.3(3) to what is not included in the principal amount of a home equity loan "(other than any interest capitalized and added to the principal balance on the date the extension of credit is made)" to apply only when interest that will accrue after the date of closing is capitalized and added to the principal on the date of closing.

•*Impermissible Open-End Account:* The plaintiffs asserted that the modifications were "a form of open-end account" in violation of subsection 50(a)(6)(F), which prohibits "a form of open-end account … unless the open-end account is a home equity line of credit [subsection 50(t)][.]" The court held that the modifications by their express terms did not create an open-end account in violation of subsection 50(a)(6)(F).

3. *Hawkins v. Wells Fargo Bank, N.A*., 2012 WL 2376272 (W.D.Tex. 2012). The Report and Recommendation issued by the magistrate judge in this case predates by two months the decision in the *Sims* case, *supra*, and involved the same modification issues. The magistrate judge in *Hawkins* recommended that the District Court deny Wells Fargo's motion to dismiss, stating "it would be more appropriate to decide those legal issues on a stipulated factual record and cross motions for summary judgment, or after a bench trial, than on a motion to dismiss."

(***Note:*** *As of the date of this memorandum, there is no District Court decision in the Hawkins case. When the District Court finally issues a decision, it may or may not be in accord with Sims.*)

K. "Additional Funds" Cases

1. *In re Harmon*, 444 B.R. 696 (Bankr.S.D.Tex. 2011). In this adversary proceeding, Harmon originally requested a home equity loan, which the lender could not provide as it was not licensed to make home equity loans in Texas. The loan was closed as a non-home equity refinance transaction (*i.e.*, rate and term refinance) in which the lender out of the loan proceeds (i) paid off a pre-existing non-home equity loan secured by Harmon's homestead, and (ii) retained $177,715 in interest prepayments, which constituted a prepayment of the interest due each month during the 12-month term of the loan, (the loan was structured as a 12-month interest only balloon loan, with the principal balance due with the final payment). After default and attempted foreclosure, Harmon filed for bankruptcy and asserted in this adversary proceeding that the loan was an illegal home equity loan void under subsection 50(a)(6). The court held:

(1) the loan was not a home equity loan under subsection 50(a)(6) but was a refinance of debt under subsection 50(a)(4);

(2) the lender's lien on Harmon's homestead was invalid because the loan did not satisfy subsection 50(e)(2), which requires, for the lien to be valid, that the advance of all additional funds in connection with the refinance of debt secured by the homestead be for "*reasonable* costs *necessary* to refinance such debt" (emphasis added); and

(3) the lender is equitably subrogated to the lien securing the prior loan it paid off in the amount of the payoff amount plus 6% interest from the date of closing.

In order to correctly apply subsection 50(e)(2), the court first evaluated the meaning of the term "necessary." Finding little authority on the meaning of "necessary" as used in subsection 50(e)(2), the court ultimately concluded that "necessary" means "an action that must occur or a cost that must be incurred to achieve a desired result." Using this definition, the court found that the $177,715 was not a necessary cost for the refinance transaction. Because there was testimony that Harmon requested this arrangement, and there was no evidence that the lender forced Harmon to borrow the $177,715 as a necessary condition to obtain the loan, the court concluded that this was not a "necessary" cost. The court further explained that even if the lender had forced Harmon to borrow the $177,715 as a condition to obtain the loan, if other lenders would not have made this a condition of the loan, then it still would not have been a "necessary" cost. Additionally, the court noted that $88,801 of the $177,715 was refunded to Harmon less than three months after the loan closed. Because this amount was refunded, this provided further evidence that it was not a necessary cost. Next, the court evaluated the meaning of the term "reasonable" and found that the $177,715, representing an advance of prepaid interest for the twelve monthly interest payments, was an unreasonable cost under subsection 50(e)(2), basing its conclusion on Interpretation §153.41 ("*reasonable costs are those costs which are lawful in light of other governing or applicable law*"). The court found that the loan was subject to §1639(g) of the Truth in Lending Act (15 U.S.C. §1639(g)), which constituted "other governing or applicable law" for the purposes of §153.41, and was in violation of §1639(g) because "more than 2 periodic payments required under the loan [were] consolidated and paid in advance from the loan proceeds provided to the consumer."

Finally, the court held that the lender was entitled to equitable subrogation to the extent the proceeds of the loan were used to pay off the balance of the preexisting debt secured by Harmon's homestead, relying on various Texas cases as authority, including the Texas Supreme Court decision in the *LaSalle Bank* case, *supra*.

*(**Note:** This bankruptcy decision has no precedential value, but, in our opinion, it is persuasive as applied the facts of this case.)*

2. *Meador v. EMC Mortg. Corp.*, 236 S.W.3d 451 (Tex.App.-Amarillo, 2007, review denied 2008), involved a homestead refinance loan and an unsecured loan made contemporaneously to the plaintiffs by the same lender. As a condition for making the unsecured loan, the lender required the plaintiffs to refinance their home mortgage. It was undisputed that the two loans were independent from one another - two loan applications were completed, a default on one did not constitute a default on the other, and the homestead refinance loan did not cover repayment of the unsecured loan. Further, after the loans were closed, only the unsecured loan was sold to the defendant, EMC. The plaintiffs asserted the unsecured loan violated section 50 because the unsecured loan represented "the advance of additional funds" under subsection 50(e), which provides that a refinance loan that includes "the advance of additional funds" is invalid against the homestead unless the loan is a home equity loan or the advance of all the "additional funds" is for reasonable and necessary refinancing costs or for another valid homestead purpose. The plaintiffs contended the unsecured loan represented "the advance of additional funds" that did not satisfy subsection 50(e) requirements. The court concluded that the lender's requirement that both loans be obtained from it did not render the two loans inseparable and that the phrase "advance of additional funds" only applies to additional funds that are secured by the homestead. We included this non-home equity case because it is possible the plaintiffs' rationale could be used in a similar situation involving a home equity loan and an unsecured loan and also because the plaintiffs apparently relied for authority on the *LaSalle Bank* appellate decision, *supra* in Section II.C.1.

III. CONSTITUTION/LEGISLATION/ADMINISTRATION

A. Constitution/Legislation

1. Urban Homestead – 10 Acres Rule. Article XVI, Section 51, of the Texas Constitution (*amended Nov. 2, 1999*) and Section 41.002(a) of the Texas Property Code (*amended Jan. 1, 2000*) provide that an urban homestead consists of a lot or contiguous lots of not more than 10 acres of land together with

any improvements thereon. This eliminates the problems lenders and owners were encountering with the prior one-acre limitation. Section 41.005(b) of the Texas Property Code (*amended Jan. 1, 2000*) provides that if the urban homestead is part of one or more contiguous lots containing more than 10 acres, then up to 10 acres of the property may be voluntarily designated as the urban homestead.

2. Definition of Urban Homestead. Section 41.002(c) of the Texas Property Code (*amended Sept. 1, 1999*) defines the urban homestead. Under Section 41.002(c), a homestead is considered urban if located within the limits of a municipality or its extraterritorial jurisdiction or a platted subdivision, and serviced by police protection, paid or volunteer fire protection, and if at least three of the following services are provided by a municipality or under contract to a municipality: (a) electric; (b) natural gas; (c) sewer; (d) storm sewer; and (e) water. The Fifth Circuit case *In Re Bouchie,* 324 F.3d 780 (5th Cir. 2003), upheld this statutory definition of urban homestead as the exclusive test for classifying Texas homesteads as urban or rural, thereby displacing prior case law on this issue, including the contrary 1992 Fifth Circuit decision in *United States v. Blakeman,* 997 F.2d 1084 (5th Cir. 1992),*Certiorari Denied*, 510 U.S. 1042, 114 S.Ct. 687, 126 L.Ed.2d 654, 62 USLW 3449, 62 USLW 3451 (U.S. Jan 10, 1994) (NO. 93-652). (**Note:** *Prior to its 1999 amendment, Section 41.002(c) defined rural homestead. The 1999 amendment deleted that definition and replaced it with the urban homestead definition.*)

3. Rural Homestead – 100/200 Acre Rule. Article XVI, Section 51, of the Texas Constitution provides that a homestead, not in a town or city, shall consist of not more than 200 acres of land, which may be in one or more parcels. Section 41.005(a) of the Texas Property Code provides that the head of a family may designate one or more parcels of land that add up to a maximum of 200 acres as a rural homestead and that a single individual may only designate one or more parcels of land totaling up to 100 acres as a rural homestead.

4. Definition of Rural Homestead. The Texas Constitution and Property Code provide for rural and urban homesteads but neither defines a rural homestead, other than the prohibition that it not be located in a town or city. Therefore, to determine if a homestead is a rural homestead, it must fail to satisfy the criteria set forth in Section 41.002(c) of the Property Code for an urban homestead. If the homestead fails to satisfy those criteria then, by default, the homestead is rural homestead to the extent it does not exceed the applicable acreage limitations set out in the above cited sections of the Constitution and Property Code.

5. Permitted Encumbrances – Texas Property Code. Section 41.001(b) of the Texas Property Code (*amended Sept. 2001*) is the statutory equivalent to Article XVI, Section 50, of the Texas Constitution in enumerating the permitted encumbrances on Texas homesteads.

6. Home Equity Agency Interpretation and Safe Harbor Provisions. Subsection 50(u) authorizes the legislature to enact legislation delegating one or more state agencies the power to interpret the following subsections (among others) of Section 50 that relate to home equity lending: 50(a)(6) [*home equity loans*], 50(f) [*home equity refinances*], 50(g) [*home equity 12-day notice disclosure*], 50(h) [*home equity acknowledgement of fair market value*], 50(i) [*protection of purchaser after foreclosure of home equity loan*], and 50(t) [*home equity line of credit loans*]. Subsection 50(u) creates a safe harbor by providing that 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 subsection 50(u) or by an appellate court of this state or the United States. Pursuant to this constitutional authority, the Texas legislature added Sections 11.308 and 15.413 to the Finance Code authorizing the Finance Commission and the Credit Union Commission (herein “Commissions”) to interpret the above subsections of Section 50. These Sections of the Finance Code also require the Commissions to adopt interpretations that are as consistent as feasible or state the justification for any inconsistency. As noted in Section II.H., some of the Interpretations issued by the Commissions pursuant to this constitutional and statutory authority were declared invalid by the appellate court decision in the *ACORN* suit, *supra*.

7. Home Equity Refinance. Subsection 50(f) permits a home equity loan authorized by subsection 50(a)(6) to be refinanced by a reverse mortgage authorized by subsection 50(a)(7). Subsection 50(p) and subsection 50(v) authorize line of credit advances under reverse mortgages.

B. Commissioner Of Insurance

1. Equity Loan Mortgage Endorsement T-42. The T-42 Endorsement (and its related procedural rule P-44) insures lenders that:

a. all owners and spouses voluntarily signed or consented to the loan instruments creating the equity lien;
b. the homestead property is not designated for agriculture use under statues governing property tax;
c. no other equity loan is secured on the homestead property;
d. no other equity loan has been secured on the homestead property within the past twelve months *(except for a "cure refinance" under subsection 50(a)(6)(Q)(x)(f))*;
e. the security instrument contains a disclosure that the loan is a homestead equity loan;
f. the closing occurred at the office of the title company; and
g. for HELOCs, subsequent disbursements and accrued interest shall have the same priority as advances made as of the policy date, except for bankruptcies prior to the disbursement and statutory liens in favor of the government arising or recorded subsequent to the policy date.

Paragraph 5 of the Exclusions from Coverage in the standard loan policy of title insurance excludes from coverage invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law. The T-42 Endorsement defines the term "consumer credit protection law" to include the provisions of subsections 50(a)(6), (g), and (t) and any statutory or regulatory requirements for a mortgage made pursuant to subsection 50(a)(6).

2. Supplemental Coverage Equity Loan Mortgage Endorsement T-42.1. The T-42.1 Endorsement (and its related procedural rule P-47) provides coverage against:

a. the insurer or its agent closing on the equity loan before the specific calendar date stated in the lender's written closing instructions;
b. the insurer or its agent dispersing any loan proceeds sooner than the fourth calendar day after closing;
c. the insurer or its agent permitting the homeowner or spouse to sign a confirmation of non-cancellation of loan on or before the date of closing;
d. the insurer or its agent failing to provide the homeowner on the date of closing with a copy of all documents related to the loan that were executed by the owner at the title company office;
e. the insurer or its agent collecting or dispersing any fees not shown on the final settlement statement provided to the lender prior to closing;
f. blanks, other than lender signature lines, in the following instruments left to be filled in when executed by homeowner at the office of the title company or its agent: the acknowledgment of fair market value, the insured mortgage and promissory note, affidavits of subsection 50(a)(6) compliance, and other documents if the documents are prepared by the insurer or its agents;
g. failure of the written acknowledgment of fair market value to be executed by the owner on the date of closing;
h. part of the land described in Schedule A of the title policy not being the homestead of the homeowner;
i. title to other land in the same county held in the name of the homeowner-borrower being currently subject to a subsection 50(a)(6) home equity loan;
j. title to other land in the same county held in the name of the homeowner-borrower being subject to a subsection 50(a)(6) home equity loan made within one year of the date of the policy; and
k. failure of the insurer or its agent to provide the owner the preclosing itemized disclosure at least one calendar day before the business day or subsequent calendar day of closing.

3. Future Advance/Revolving Credit Endorsement T-35. This endorsement insures lenders against the invalidity, unenforceability, and lack of priority for (i) each advance or re-advance of loan proceeds made subsequent to the policy date, (ii) lack of outstanding indebtedness before an advance, or (iii) failure to comply with the requirements of state law to secure advances, except as to

(i) bankruptcies filed by or on behalf of the mortgagor prior to the date of any advance, (ii) post-policy real estate taxes, (iii) advance made more that 45 days after a federal tax lien, (iv) federal or state environmental protection liens, or (v) usury or any consumer credit protection or truth-in-lending law.

4. Junior Mortgage Title Insurance. Under limited circumstances, institutional lenders may obtain limited coverage for subordinate lien closed-end home equity loans and HELOCS under the T-44 Texas Residential Limited Coverage Junior Mortgagee Policy, the T-45 Texas Residential Limited Coverage Junior Mortgagee Policy Down Date Endorsement, and the T-46 Texas Residential Limited Coverage Junior Mortgagee Policy Home Equity Line of Credit/Variable Rate Endorsement. The above coverage can be issued if: (a) the homestead is encumbered by one or more prior recorded mortgages; (b) the homestead is located in a recorded platted subdivision or is five acres or less; (c) the lender is an institutional lender; (d) the loan is a junior mortgage made pursuant to subsection 50(a)(6); and (e) the loan will not exceed $100,000. The advantage of this insurance is the premiums are less for the Policy and the Endorsements than the premiums for the standard T-2 Loan Policy and T-42 and T-42.1 Endorsements. The disadvantage is that the coverage is reduced. The T-42 and T-42.1 Endorsements are not available nor is P-39 express insurance or other coverage or endorsements applicable to the standard T-2 policy.

The T-44 Policy and the T-45 and T-46 Endorsements provide coverage against: (1) prior home equity mortgages; (2) prior home equity mortgages within 12 months of policy date; and (3) prior monetary liens. Additionally, they insure lenders that: (1) the homestead property is not designated for agriculture use under statutes governing property tax; and (2) for HELOCs, subsequent disbursements and accrued interest shall have the same priority as advances made as of the date of the HELOC's recording, except for bankruptcies prior to the disbursement and statutory liens in favor of the government arising or recorded subsequent to the policy date.

C. Attorney General Opinions

There have been no home equity related Texas Attorney General opinions since the May 29, 1998 advisory letter and the December 21, 1998 opinion DM-495. While they have not been withdrawn, due to subsequent events and amendments they no longer provide any effective guidance.

D. Home Equity Interpretations By The Commissions

1. General (Closed-end/Open-end Credit). Official Interpretations of subsections 50(a)(6), 50(e) and 50(g), approved by the Commissions pursuant to their authority under subsection 50(u), Article XVI, Texas Constitution and Sections 11.308 and 15.413 of the Finance Code, first became effective January 8, 2004. You may obtain a copy of the current Interpretations by accessing Title 7, Part 8, Chap. 153 of the Texas Administrative Code at:

http://info.sos.state.tx.us/pls/pub/readtac$ext.ViewTAC?tac_view=4&ti=7&pt=8&ch=153&rl=Y.

The general Interpretations for closed-end/open-end credit in this Section II.D.1. are contained in Chapter 153 of the Texas Administrative Code, 7 TAC §§153.1 - 153.5, 153.7 - 153.18, 153.20, 153.22, 153.24, 153.25, 153.41, 153.51, and replace the October 7, 1998 Regulatory Commentary on Equity Lending Procedures and the December 20, 2001 "Joint Agency Letter" issued by the Office of Consumer Credit Commissioner, the Department of Banking, the Savings and Loan Department (now named the Department of Savings and Mortgage Lending), and the Credit Union Department. These state agencies regulate our state financial institutions and other entities that make loans, including home equity loans. Unlike the Regulatory Commentary and the Joint Agency Letter, the Interpretations provide a legal "safe harbor" for an act or omission that conforms to an Interpretation in effect at the time of the act or omission. This Section III.D.1. republishes the current version of the above cited Interpretations and, where appropriate, also adds an **Our Comment** to point out our concerns and some problem areas. Except for the definitions in §153.1, each Interpretation corresponds with an identified provision of subsections 50(a)(6), 50(e) and 50(g):

§153.1. Definitions. Any reference to Section 50 in this interpretation refers to Article XVI, Texas Constitution, unless otherwise noted. These words and terms have the following meanings when used in this section, unless the context indicates otherwise:

(1) Balloon – an installment that is more than an amount equal to twice the average of all installments scheduled before that installment.

(2) Business Day – All calendar days except Sundays and these federal legal public holidays: New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day.

(3) Closed or closing – the date when each owner and the spouse of each owner signs the equity loan agreement or the act of signing the equity loan agreement by each owner and the spouse of each owner. **Our Comment:** If the owner and spouse sign on different days, the date of last signing is the "closing" date.

(4) Consumer Disclosure – The written notice contained in Section 50(g) that must be provided to the owner at least 12 days before the date the extension of credit is made.

(5) Cross-default provision – a provision in a loan agreement that puts the borrower in default if the borrower defaults on another obligation.

(6) Date the extension of credit is made – the date on which the closing of the equity loan occurs. **Our Comment:** Subsection 50(a)(6)(L) requires the first periodic installment to be no later than "two months from the date the extension of credit is made." Revised Interpretation §153.11 interprets the "two months" of Subsection 50(a)(6)(L) to begin on the date of "closing." This means you cannot avoid a short-pay situation by scheduling the first installment date of the note to be the first day of the second month after the month of funding if funding occurs in the next month after the month of "closing."

(7) Equity loan – An extension of credit as defined and authorized under the provisions of Section 50(a)(6). **Our Comment:** Subsection 50(a)(6)(F) states that an equity loan "is not a form of open-end account … unless the open-end account is a home equity line of credit". Thus, the definition of equity loan in §153.1(7) includes a home equity line of credit under Section 50(t), and the Interpretations will apply to home equity line of credit loans as well. In their preamble to the Interpretations, the Commissions state "[t]he term 'Equity loan' in Chapter 153 includes home equity lines of credit, unless specifically excluded."

(8) Equity loan agreement – the documents evidencing the agreement between the parties of an equity loan.

(9) Fair Market Value – the fair market value of the homestead as determined on the date that the loan is closed.

(10) Force-placed insurance – insurance purchased by the lender on the homestead when required insurance on the homestead is not maintained in accordance with the equity loan agreement.

(11) Interest – interest as defined in the Texas Finance Code §301.002(4) and as interpreted by the courts. **Our Comment:** In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.1(11). See Section II.H. for a discussion of the appellate court's decision invalidating §§153.1(11) and 153.5(3).

(12) Lockout provision – a provision in a loan agreement that prohibits a borrower from paying the loan early.

(13) Owner – A person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead. **Our Comment:** We believe this definition makes a non-borrower non-titled spouse an "owner" for all purposes under Section 50(a)(6). Section 50(b), Article XVI, Texas Constitution, Section 5.001 of the Texas Family Code, Section 284 of the Texas Probate Code, and Texas case law (see, for example, *Wilcox v. Marriott,* 102 S.W.3d 469 (Tex.App. – San Antonio 2003)) give the spouse (whether or not in title and whether or not the homestead is community or separate property) all the rights contained in this definition. We believe this means that the non-borrower non-titled spouse, as a defined *owner* under §153.1(13), must: (i) join in the submission of the loan application referred to in subsection 50(a)(6)(M)(i); (ii) receive the *Consumer Disclosure* required by Section 50(g) and the *Preclosing Disclosure* and a copy of the loan application required by subsection 50(a)(6)(M)(ii); and, (iii) sign the written acknowledgment as to the fair market value of the homestead property required by subsection 50(a)(6)(Q)(ix). Contrary to this definition, we do not believe the intent of Section 50(a)(6) is to

make the term "owner" synonymous with "owner and spouse" (compare *50(a)(6) subsections (J); (M); (P)(iv)-(v); (Q)(i)-(v), (vii), (ix), (x)(a)-(c), (e)-(f), in which only "owner" is used, to subsections (A); (C); (E); (Q)(viii) and (xi), in which the spouse of the "owner" is included*). *See also* Section IV.D. "Non-Titled Spouse" for further explanations and case authority.

(14) Preclosing Disclosure – The written itemized disclosure required by Section 50(a)(6)(M)(ii).

(15) Three percent limitation – the limitation on fees in Section 50(a)(6)(E).

§153.2. Voluntary Lien: Section 50(a)(6)(A). An equity loan must be secured by a voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse.

(1) The consent of each owner and each owner's spouse must be obtained, regardless of whether any owner's spouse has a community property interest or other interest in the homestead.

(2) An owner or an owner's spouse who is not a maker of the note may consent to the lien by signing a written consent to the mortgage instrument. The consent may be included in the mortgage instrument or a separate document. **Our Comment:** We believe that the consent of the owner's spouse to a lien on the homestead by execution of a document separate from the lien instrument violates Section 50(c), Article XVI, of the Texas Constitution, Section 5.001 of the Family Code, and Texas case law (see *Villarreal v. Laredo National Bank*, 677 S.W.2d 600 (Tex.App. – San Antonio 1984)), all of which require that the spouse execute the lien instrument. We do not recommend the practice of consent by a separate document. We recommend that the owner and owner's spouse always sign the mortgage instrument.

(3) The lender, at its option, may require each owner and each owner's spouse to consent to the equity loan. This option is in addition to the consent required for the lien.

§153.3. Limitation on Equity Loan Amount: Section 50(a)(6)(B). An equity loan must be 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. For example, on a property with a fair market value of $100,000, the maximum amount of debt against the property permitted by Section 50(a)(6)(B) is $80,000. Assuming existing debt of $30,000, the maximum amount of the equity loan debt is $50,000.

(1) The principal amount of an equity loan is the sum of:

(A) the amount of the cash advanced; and

(B) the charges at the inception of an equity loan to the extent these charges are financed in the principal amount of the loan.

(2) The principal balance of all outstanding debt secured by the homestead on the date the extension of credit is made determines the maximum principal amount of an equity loan.

(3) The principal amount of an equity loan 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.

(4) On a closed-end multiple advance equity loan, the principal balance also includes contractually obligated future advances not yet disbursed.

§153.4. Nonrecourse: Section 50(a)(6)(C). An equity loan must be 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.

(1) If an owner or the spouse of an owner cosigns an equity loan agreement or consents to a security interest, the equity loan must not give the lender personal liability against an owner or an owner's spouse.

(2) A lender is prohibited from pursuing a deficiency except when the owner or owner's spouse has committed actual fraud in obtaining an equity loan.

(3) To determine whether a lender may pursue personal liability, the borrower or owner must have committed "actual fraud." To obtain personal liability under this section, the deceptive conduct must constitute the legal standard of "actual fraud." Texas case law distinguishes "actual fraud" from "constructive fraud." "Actual fraud" encompasses dishonesty of purpose or intentional breaches of duty that are designed to injure another or to gain an undue and unconscientious advantage.

§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. **Our Comment:** (1) In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(3). See Section II.H. for a discussion of the appellate court's decision invalidating §§153.1(11) and 153.5(3). (2) Unfortunately, while §153.5(3) provides that "points" are interest and not fees subject to the 3% limitation, it does not define "points." Under Texas usury law and rules issued by the Office of the Consumer Credit Commissioner, origination fees and discount points paid to the lender funding the loan are generally considered interest. See, *First Bank v. Tony's Tortilla Factory, Inc*., 877 S.W.2d 285 (Tex. 1994) [fees as interest]*; Tarver v. Sebring Capital Credit Corporation*, 69 S.W.3d 708 (Tex.App.-Waco 2002, no pet.) [discount points] summarized in Section II.A.5.*; 7 TAC §83.707(f) and (g)* [discount points; origination fees]. But see also the *Breaux* and *Thomison* cases discussed in Section II.A.3. and 4. for confusing federal district court opinions on this issue. Origination fees charged and retained by a mortgage broker are not interest. See, *Victoria Bank & Trust Co. v. Brady*, 811 S.W.2d 931 (Tex. 1991) [third party services]*; 7 TAC §83.707(d) and §153.5(7)* [broker fees]. By using the term "points" (a term that is used throughout the mortgage industry to refer to origination fees and discount points paid to mortgage lenders and mortgage brokers), it is not possible to discern whether the term "points" as used in §153.5(3) includes origination fees paid to the lender or excludes origination fees and "points" paid to the mortgage broker.

(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. **Our Comment:** In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(4). See Section II.H. for a discussion of the appellate court's decision.

(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. **Our Comment:** (1) In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(6). See Section II.H. for a discussion of the appellate court's decision. (2) See also Our Comment (2) in §153.5(3) above.

(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. **Our Comment:** In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(8). See Section II.H. for a discussion of the appellate court's decision.

(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. **Our Comment:** (1) In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(9). See Section II.H. for a discussion of the appellate court's decision. (2) This Interpretation neither gives an example of a fee "to maintain the loan" nor an example of what is meant by deferring payment to a later date. Would this post-closing paid charge include a charge included in the loan amount? It is unclear, but we believe that it does.

(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. **Our Comment:** (1) In the ACORN case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating §153.5(12). See Section II.H. for a discussion of the appellate court's decision. (2) This Interpretation neither gives an example of a fee "to service the loan" nor an example of what is meant by deferring payment to a later date. Would this later paid charge include a charge included in the loan amount? It is unclear, but we believe that it does.

(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). **Our Comment:** See also the Fifth Circuit's decision in the *Doody* case discussed in Section II. A.1.

(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 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. **Our Comment:** But see also new §153.14(2)(D) and the related Our Comment.

(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. **Our Comment:** See also the Fifth Circuit's decision in the *Doody* case discussed in Section II. A.1.

§153.6. *– Reserved for future expansion*

§153.7. Prohibition on Prepayment Penalties: Section 50(a)(6)(G). An equity loan may be paid in advance without penalty or other charge.

(1) A lender may not charge a penalty to a borrower for paying all or a portion of an equity loan early.

(2) A lockout provision is not permitted in an equity loan agreement because it is considered a prepayment penalty.

§153.8. Security of the Equity Loan: Section 50(a)(6)(H). An equity loan must not be secured by any additional real or personal property other than the homestead. The definition of "homestead" is located at Section 51 of Article XVI, Texas Constitution, and Chapter 41 of the Texas Property Code.

(1) A lender and an owner or an owner's spouse may enter into an agreement whereby a lender may acquire an interest in items incidental to the homestead. An equity loan secured by the following items is not considered to be secured by additional real or personal property:

(A) escrow reserves for the payment of taxes and insurance;

(B) 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;

(C) insurance proceeds related to the homestead;

(D) condemnation proceeds;

(E) fixtures; or

(F) easements necessary or beneficial to the use of the homestead, including access easements for ingress and egress.

Our Comment: The Commissions declined to offer an Interpretation concerning whether an easement is included in the homestead acreage limitations of Section 51, Article XVI, Texas Constitution. Therefore, until the appellate courts or the Commissions by future Interpretation give clarification on this issue, we recommend that all easements included in the "Equity loan agreement" property description be included in determining if homestead acreage limitations are exceeded.

(2) A guaranty or surety of an equity loan is not permitted. A guaranty or surety is considered additional property for purposes of Section 50(a)(6)(H). Prohibiting a guaranty or surety is consistent with the prohibition against personal liability in Section 50(a)(6)(C). An equity loan with a guaranty or surety would create indirect liability against the owner. The constitutional home equity lending provisions clearly provide that the homestead is the only allowable collateral for an equity loan. The constitutional home equity provisions prohibit the lender from contracting for recourse of any kind against the owner or owner's spouse, except for provisions providing for recourse against the owner or spouse when the extension of credit is obtained by actual fraud.

(3) A contractual right of offset in an equity loan agreement is prohibited.

(4) A contractual cross-collateralization clause in an equity loan agreement is prohibited.

(5) Any equity loan on an urban homestead that is secured by more than ten acres is secured by additional real property in violation of Section (50)(a)(H). **Our Comment:** See Our Comment to §153.8(1).

§153.9. Acceleration: Section 50(a)(6)(J). An equity loan 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.

(1) An equity loan agreement may contain a provision that allows the lender to accelerate the loan because of a default under the covenants of the loan agreement. Examples of these provisions include a promise to maintain the property or not remove improvements to the property that indirectly affects the market value of the homestead.

(2) A contractual cross-default clause is permitted only if the lien associated with the equity loan agreement is subordinate to the lien that is referenced by the cross default clause.

§153.10. Number of Loans: Section 50(a)(6)(K). An equity loan must be 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 Section 50(a)(1)-(a)(5) or (a)(8).

(1) Number of Equity Loans. An owner may have only one equity loan at a time, regardless of the aggregate total outstanding debt against the homestead. **Our Comment:** Because the definition of a home equity loan includes a home equity line of credit under Section 50(t) [see Our Comment to §153.1(7)], this precludes a closed-end home equity loan and a home equity line of credit existing at the same time against the same homestead.

(2) Loss of Homestead Designation. If under Texas law the property ceases to be the homestead of the owner, then the lender, for purposes of Section 50(a)(6)(K), may treat what was previously a home equity mortgage as a non-homestead mortgage.

§153.11.[1] Repayment Schedule: Section 50(a)(6)(L)(i). Unless an equity loan is a home equity line of credit under Section 50(t), the loan must be scheduled to be repaid 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.

(1) The two month time period contained in Section 50(a)(6)(L)(i) begins on the date of closing. **Our Comment:** (1) The term "closing" is defined in §153.1(3) as "the date when each owner and the spouse of each owner signs the equity loan agreement or the act of signing the equity loan agreement by each owner and the spouse of each owner." Note, however, that if an owner and spouse sign on different days, or if non-married owners sign on different days, the date of last signing is the date of "closing." (2) See also the "short-pay" Our Comment to §153.1(6).

(2) For purposes of Section 50(a)(6)(L)(i), a month is the period from a date in a month to the corresponding date in the succeeding month. For example, if a home equity loan closes on March 1, the first installment must be due no later than May 1. If the succeeding month does not have a corresponding date, the period ends on the last day of the succeeding month. For example, if a home equity loan closes on July 31, the first installment must be due no later than September 30.

(3) For a closed-end equity loan to have substantially equal successive periodic installments, some amount of principal must be reduced with each installment. This requirement prohibits balloon payments. **Our Comment:** Although this Interpretation does not say so, presumably the prohibition against balloon payments will apply to home equity line of credit loans as well.

(4) Section 50(a)(6)(L)(i) 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.

[1] Revised Interpretation §153.11 effective November 13, 2008.

§153.12.[2] 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. One copy of the required consumer disclosure may be provided to married owners. For purposes of determining the earliest permitted closing date, the next succeeding 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 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 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.

(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. **Our Comment:** In the *ACORN* case summarized in Section II.H., the appellate court reversed the trial court's judgment invalidating the "oral application" portion of §153.12(2).

[2] Revised Interpretation §153.12 effective November 13, 2008. ***Note:*** *This revision did not change §153.12(2).*

§153.13.[3] 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 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 preclosing disclosure to the owner or the lender may modify the previously provided preclosing disclosure on the date of closing.

(1) For purposes of this section, the "preclosing disclosure" consists of 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.

(2) The copy of the loan application submitted to the owner in satisfaction of the preclosing disclosure requirement must be the most current version at the time the document is delivered. The lender is not obligated to provide another copy of the loan application if the only difference from the version previously provided to the owner is formatting. The lender is not obligated to give another copy of the loan application if the information contained on the more recent application is the same as that contained on the application of which the owner has a copy.

(3) A lender may satisfy the disclosure requirement of providing a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing by delivery to the borrower of a properly completed Department of Housing and Urban Development (HUD) disclosure Form HUD-1 or HUD-1A.

(4) 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.

(5) 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.

(6) 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.

(7) 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.

[3] Revised Interpretation §153.13 effective November 13, 2008.

Our Comment: (1) In 2006 the Commissions revised §153.13. One of the revisions deleted from the de minimis good cause standard the section allowing a decrease in fees and charges, which section read as follows: "one or more items **…** [*i.e.*, fees, points, costs and charges] is less than the disclosed rate or amount on the initial preclosing disclosure." In the preamble to the 2006 revision of §153.13, published in the June 23, 2006 issue of the *Texas Register*, the Commissions stated that, notwithstanding this deletion, revised "*§153.13 would allow the lender to reduce fees or closing costs by any amount without postponing the date of closing.*" … "[A] *reduction in fees would not trigger the need for an owner's consent to forego a delay in the closing date*", concluding, "*this is self-evident from the language of the interpretation.*" As a corollary to this revision, the Commissions explained in the preamble that an unanticipated "de minimis" charge added after the preclosing disclosure has been given also would not require a redisclosure or delay in closing, stating: "*Occasionally, unanticipated additional fees arise in an equity loan transaction shortly before closing. For example, the invoice for a courier or delivery fee may not arrive in time for the preclosing disclosure, and including the fee in the final documents could force a delay in closing the equity loan. This provision* [the de minimis good cause standard] *recognizes that postponing the date of closing may adversely affect the owner more than the amount of variance between disclosed and actual closing costs. It also allows the owner to decide if hardship would result from postponing the closing for de minimis variances in costs.*" We do not agree with the Commissions' analysis in the preamble that unanticipated additional "de minimis" charges that arise after delivery of the preclosing disclosure are covered by the de minimis good cause standard in §153.13. In this instance, we advise lenders to redisclose because the Commissions' preamble statements are not part of the official Interpretation and, thus, may not provide safe harbor protection under Section 50(u) should a lender fail to redisclose after de minimis charge(s) are added.

(2) In our 2006 comments to the Commissions on the proposed revisions to §153.13, we requested that proposed §153.13(3)(C)(ii) [now §153.13(5)(C)(ii)] be revised to read as follows: *"specifically states that the owner consents to receive a subsequent or modified preclosing disclosure on the date of closing.*" In the preamble to revised §153.13, published in the June 23, 2006 issue of the *Texas Register*, the Commissions agreed to make this change, stating: "*The commissions agree with the commenter and modified the language of §153.13 as suggested. This modification clarifies the application of subsection (3)(C)(ii) … .*" However, §153.13(3)(C)(ii) did not, and as renumbered §153.13(5)(C)(ii) by the Commissions' 2008 revision to §153.13 does not, contain the suggested change. We believe this is due to an inadvertent publishing or editing error.

(3) In 2008 the Commissions again revised and rearranged §153.13 to conform it to the 2007 constitutional amendment to subsection 50(a)(6)(M)(ii) prohibiting a loan from closing before "one business day after the date that the owner receives a copy of the loan application if not previously provided." New §153.13(2) interprets this constitutional requirement to mean that reformatting a loan application previously provided to the owner does not require the lender to provide the owner with another copy of the loan application prior to closing. The Commissions, however, state in the preamble published with new §153.13(2) (November 7, 2008 issue of the *Texas Register*) that correcting minor errors in the application would require the lender to provide the corrected loan application to the owner prior to closing "*because such application[s] would contain different information.*" This means that if the information contained in the most current version of the loan application (some lenders call this the "final application") differs in any way (*e.g.*, addition, deletion, change or correction) from the information contained in the copy of the application previously provided to the owner, the lender must provide the owner with a copy of the final loan application prior to

closing. Because a final loan application may, in many instances, contain minor informational changes from the copy of the loan application previously provided to the owner, in order not to run afoul of the Commissions' preamble statement quoted above, we recommend that lenders always provide the owner a copy of the final loan application prior to closing. Remember also, that Section 50(a)(6)(Q)(v) and §153.22 require the lender to provide at closing a copy of the final loan application after it is signed, resulting in the owner receiving pre-and post-closing copies of the final loan application.

(4) The 2007 amendment to subsection 50(a)(6)(M)(ii) and the 2008 revision to §153.13 mean that if a copy of the most current version of the loan application and the preclosing HUD-1 are not provided to the borrower on the same day, the loan cannot close before one business day after the later of the date that the borrower receives a copy of the most current version of the loan application or the date that the borrower receives the preclosing HUD-1.

§153.14.[4] 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.

(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.

Our Comment: There has been much confusion in the lending community regarding this requirement. In order to clarify this issue, please note that the one year prohibition is limited to the same homestead – it does not apply to a new homestead acquired by the consumer – and it starts from the closing date of the prior home equity loan, not the recording date of the equity loan agreement.

(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 of a home equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. A home equity loan and a subsequent modification will be considered a single transaction. The home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.

(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.

(D) The 3% fee cap required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction.

Our Comment: New §153.14(2)(D) makes it clear that only one 3% fee cap applies to the original home equity loan and any modification(s) in the aggregate (*i.e.*, any fees paid by the borrower at modification that are subject to the Section 50(a)(6)(E) 3% fee cap must be added to all prior fees subject to the Section 50(a)(6)(E) 3% fee cap to determine if the 3% fee cap of the home equity loan as modified has been exceeded).

[4] Revised Interpretation §153.14 effective November 13, 2008.

§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. **Our Comment:** §153.15 interprets "lender" as anyone authorized under Section 50(a)(6)(P) to make equity loans who "advances funds directly to the owner or is identified as the payee on the note." This means a mortgage broker who closes an equity loan in the broker's name can close that loan at the broker's permanent physical address, but a mortgage broker who closes in the lender's name cannot. In the preamble to the final Interpretations, the Commissions specifically declined to limit the term "attorney" to a Texas licensed attorney and stated "[t]*he Commissions do not believe that attorneys must be licensed in Texas to close equity loans*." But since this statement is not part of the official Interpretation, until the Commissions or an appellate court clarify this issue, we recommend that an attorney closing an equity loan be a Texas licensed attorney. In the preamble, the Commissions also stated that closings could occur outside of Texas (**note** – the closings must still occur at one of the above authorized locations).

(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. **Our Comment:** The execution of the closing documents by the attorney in fact must occur at one of the above authorized locations.

(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. **Our Comment:** We are not sure if this Interpretation allows an owner or spouse to consent to the equity loan by signing the equity loan agreement or other consent instrument at a location other than an authorized location and then mailing it to the lender at an authorized location. See §153.2(2) above.

Our Comment: In the *ACORN* case summarized in Section II.H., ACORN challenged §§153.15(2) and (3). The District Court denied ACORN's challenge and the appellate court affirmed the trial court's judgment upholding §153.15.

§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.

Our Comment: See also §153.11(3).

(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. **Our Comment:** Although not stated, implicit in this Interpretation is that step-rate and discounted ARM loans also must comply with the requirements of §153.16 (1) through (4).

§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) [*sic*]. **Our Comment:** This also excludes lenders approved only to make VA loans unless they qualify under another subsection of Section 50(a)(6)(P). ***Note:*** *Effective May 20, 2010, HUD no longer approves applicants as loan correspondents.*

(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. **Our Comment:** Effective September 1, 2007, Chapter 342 was amended by the addition of §342.051(f) to exclude mortgage brokers licensed under Chapter 156, Texas Finance Code, from licensing under Chapter 342. Effective September 1, 2011, §342.051(f) was repealed and §342.051(c-1) was added to exclude a person who is licensed or registered under Chapter 156 or 157, Texas Finance Code, from licensing under Chapter 342. These statutory changes may require a corresponding amendment to §153.17(3).

(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). **Our Comment:** See Our Comment to §153.17(3) above.

§153.18.[5] 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.

[5] Revised Interpretation §153.18 effective June 29, 2006.

Our Comment: The 2006 revisions to §153.18, while not extensive, are significant. First, the prohibitory statement in former subsection (2) [now subsection (1)] that, "[t]he lender may not otherwise specify or restrict the use of the proceeds" is deleted; thus, removing the former uncertainty whether a lender could make a home equity loan for home improvement purposes and require as a condition of the loan that the owner pay the contractor for the improvements. Second, with the deletion of former subsection (3) [the "debt consolidation" Interpretation], the risk to a home equity lender "voluntarily" receiving a payment on a non-homestead debt owed to it by the owner without violating section 50(a)(6)(Q)(i) is increased because there is now no interpretative authority as to when such a payment is truly

voluntary. Deleted former subsection (3) stated: "*When an owner applies for a debt consolidation loan, it is the owner, not the lender, that is requiring that proceeds be applied to another debt. If the proceeds of a home equity loan are used in conformity with owner's credit application the limitations of this section* [subsection 50(a)(6)(Q)(i)] *do not apply.*" Without the "debt consolidation" protection afforded by former §153.18(3), the voluntary nature of the payment will be a question of fact to be determined by a court proceeding. See, *Box v. First State Bank, Bremond S.S.B.* in Section II.B.2. and our recommendations in Section IV.E.

§153.19. – *Reserved for future expansion*

§153.20.[6] No Blanks in Any Instrument: Section 50(a)(6)(Q)(iii). A home equity loan must be made on the condition that the owner of the homestead not sign any instrument in which blanks are left to be filled in.

(1) This Section of the Constitution prohibits the owner of the homestead from signing any instrument in which blanks are "left to be filled in". This Section is intended to prohibit a person other than the owner from completing one or more blanks in an instrument after the owner has signed the instrument and delivered it to the lender, thereby altering a party's obligation created in the instrument. Not all documents or records executed in connection with an equity loan are instruments, and not all blanks contained in an instrument are "blanks that are left to be filled in" as contemplated by this Section.

(2) As used in this Section, the term instrument means a document or record that creates or alters a legal obligation of a party. A disclosure required under state or federal law is not an instrument if the disclosure does not create or alter the obligation of a party.

(3) If at the time the owner signs an instrument, a blank is completed or box checked which indicates the owner's election to select one of multiple options offered (such as an election to select a fixed rate instead of an adjustable rate) and the owner therefore by implication has excluded the non-selected options, the instrument does not contain "blanks left to be filled in" when the non-selected option is left blank.

[6] Revised Interpretation §153.20 effective June 29, 2006.

Our Comment: (1) Revised §153.20 is more specific than the former Interpretation. We do not believe, however, it is a change in substance but only a more explicit interpretation of what documents and blanks are covered. (2) In addition, the 2007 amendments to Section 50 amended Section 50(a)(6)(Q)(iii) to read "the owner of the homestead not sign any instrument in which blanks relating to substantive terms of agreement are left to be filled in." (**emphasis added**)

§153.21. – *Reserved for future expansion*

§153.22.[7] Copies of Documents: Section 50(a)(6)(Q)(v). At closing, the lender must provide the owner with a copy of the final loan application and all executed documents that are signed by the owner at closing in connection with the equity loan. One copy of these documents may be provided to married owners. This requirement does not obligate the lender to give the owner copies of documents that were signed by the owner prior to or after closing.

[7] Revised Interpretation §153.22 effective July 10, 2008.

Our Comment: (1) In the *ACORN* case summarized in Section II.H., the District Court declared the pre-2008 version of §153.22 invalid. The 2008 revision removed the portions of §153.22 considered invalid by the District Court. The appellate court stated that this revised version is consistent with the 2007 amended section 50(a)(6)(Q)(v), which rendered moot ACORN's challenge. As a result, the appellate court reversed the trial court's judgment invalidating §153.22. (2) Under revised §153.22, lenders have the added burden of providing at closing a copy of the final loan application and a copy of the loan documents only after they are signed. (3) Lenders will no longer be required to provide the borrowers a copy of post-closing documents. (3) Married owners are only entitled to one copy of the executed closing documents.

§153.23. – *Reserved for future expansion*

§153.24. Release of Lien: Section 50(a)(6)(Q)(vii). The lender must cancel and return the note to the owner and give the owner a release of lien or a copy of an endorsement and assignment of the lien to another lender refinancing the loan within a reasonable time after termination and full payment of the loan. The lender or holder, at its option, may provide the owner a release of lien or an endorsement and assignment of the lien to another lender refinancing the loan.

(1) The lender will perform these services and provide the documents required in 50(a)(6)(Q)(vii) without charge.

(2) This section does not require the lender to record or pay for the recordation of the release of lien.

(3) Thirty days is a reasonable time for the lender to perform the duties required under this section.

(4) An affidavit of lost or imaged note, or equivalent, may be returned to the owner in lieu of the original note, if the original note has been lost or imaged.

§153.25. Right of Rescission: Section 50(a)(6)(Q)(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.

(1) This provision gives the owner's spouse, who may not be in record title or have community property ownership, the right to rescind the transaction.

(2) The owner and owner's spouse may rescind the extension of credit within three calendar days. If the third calendar day falls on a Sunday or federal legal public holiday then the right of rescission is extended to the next calendar day that is not a Sunday or federal legal public holiday.

(3) A lender must comply with the provisions of the Truth-in-Lending Act permitting the borrower three business days to rescind a mortgage loan in applicable transactions. Lender compliance with the right of rescission procedures in the Truth-in-Lending Act and Regulation Z, satisfies the requirements of this section if the notices required by Truth-in-Lending and Regulation Z are given to each owner and to each owner's spouse.

Our Comment: A state-specific rescission notice **should not be given** in addition to the federal rescission notice mandated by Regulation Z for the following reasons: (1) All Texas home equity loans are subject to the federal right of rescission required by Regulation Z (*see §§1026.23(a), (b) and (f)*). (2) The federal rescission notice mandated by Regulation Z controls notwithstanding conflicting state law (*see §1026.28(a)*). (3) The Texas rescission period is three calendar days whereas the federal rescission period is three business days. The Texas rescission period runs concurrently with the federal rescission period, and does not conflict with it (*see*, *Rooms With A View, Inc. v. Private National Mortgage Association*, 7 S.W.3d 840 (Tex. App. – Austin 1999, no pet.)). (4) Section 50(a)(6)(Q)(viii) does not require a rescission notice. (5) There is federal case law to support the position that giving inconsistent rescission notices voids the required federal rescission notice and thereby allows the consumer up to three years to rescind the loan. *See*, *Williams v. Empire Funding Corp.*, 109 F.Supp.2d 352 (E.D.Pa., 2000); *Jones v. Ameriquest Mortgage Co.*, 2006 WL 273545 (N.D.Ill.–Eastern Division, 2006); and *Hamm v. Ameriquest Mortgage Co.*, 506 F.3d 525 (7th Cir. 2007), Certiorari Denied, 552 U.S. 1280, 128 S.Ct. 1706, 170 L.Ed.2d 513, 76 USLW 3406, 76 USLW 3508, 76 USLW 3510 (U.S. Mar 24, 2008) (NO. 07-941). (6) §153.25(3) provides that compliance with the right of rescission procedures in Regulation Z satisfies the state rescission requirements of Section 50(a)(6)(Q)(viii).

§§153.26 - 40. – *Reserved for future expansion*

§153.41. Refinance of a Debt Secured by a Homestead: Section 50(e). A refinance of debt secured by a homestead and described by any subsection under Subsections (a)(1)-(a)(5) of Section 50 of the Texas Constitution 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) or (a)(7) of Section 50 of the Texas Constitution; 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 Section 50 of the Texas Constitution.

(1) Reasonableness and necessity of costs relate to the type and amount of the costs.

(2) In a secondary mortgage loan, reasonable costs are those costs which are lawful in light of the governing or applicable law that authorizes the assessment of particular costs. In the context of other mortgage loans, reasonable costs are those costs which are lawful in light of other governing or applicable law. **Our Comment:** For a similar Interpretation relating to home equity loans see §153.5 (13).

(3) Reasonable and necessary costs to refinance may include reserves or impounds (escrow trust accounts) for taxes and insurance, if the reserves comply with applicable law.

Our Comment: Interpretation §153.41 also applies to rate and term refinance loans.

§§153.42 - 50. – *Reserved for future expansion*

§153.51.[8] Consumer Disclosure: Section 50(g). An equity loan may not be closed before the 12th day after the lender provides the owner with the consumer disclosure on a separate instrument.

(1) If a lender mails the consumer disclosure to the owner, the lender shall allow a reasonable period of time for delivery. A period of three calendar days, not including Sundays and federal legal public holidays, constitutes a rebuttable presumption for sufficient mailing and delivery.

(2) Certain provisions of the consumer disclosure do not contain the exact identical language concerning requirements of the equity loan that have been used to create the substantive requirements of the loan. The consumer notice is only a summary of the owner's rights, which are governed by the substantive terms of the constitution. The substantive requirements prevail regarding a lender's responsibilities in an equity loan transaction. A lender may supplement the consumer disclosure to clarify any discrepancies or inconsistencies.

(3) A lender may rely on an established system of verifiable procedures to evidence compliance with this section.

(4) A lender whose discussions with the borrower are conducted primarily in Spanish for a closed-end loan may rely on the translation of the consumer notice developed under the requirements of Texas Finance Code, §341.502. Such notice shall be made available to the public through publication on the Finance Commission's webpage.

[8] Revised Interpretation §153.51 effective November 13, 2008. ***Note:*** *New §153.51(4) was added. Existing §§153.51(1), (2), and (3) were not changed.*

Our Comment: (1) In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment denying ACORN's challenge to §§153.51(1) and (3). (2) Do not be confused by the phrase "for a closed-end loan" in new §153.51(4); the Spanish language disclosure on the Finance Commission's webpage applies to HELOC loans as well.

2. Open-end Credit. Official Interpretations of the HELOC provisions of subsection 50(t), approved by the Commissions pursuant to their authority under subsection 50(u), Article XVI, Texas Constitution and Sections 11.308 and 15.413 of the Finance Code, became effective March 11, 2004. The Interpretations are contained in Chapter 153 of the Texas Administrative Code, 7 TAC §§153.82, 153.84 - 153.88, and provide a legal "safe harbor" for an act or omission that conforms to an Interpretation in effect at the time of the act or omission. You may obtain a copy of the current Interpretations by accessing Title 7, Part 8, Chap. 153 of the Texas Administrative Code at: http://info.sos.state.tx.us/pls/pub/readtac$ext.ViewTAC?tac_view=4&ti=7&pt=8&ch=153&rl=Y.

This Section III.D.2. republishes the current version of the above cited Interpretations and, where appropriate, also adds an **Our Comment** to point out our concerns and some problem areas. Each Interpretation corresponds with an identified provision of subsection 50(t):

§153.82. Owner Requests for HELOC Advance: Section 50(t)(1). A home equity line of credit (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 the owner requests advances, repays money, and reborrows money. Any owner who is also a named borrower on the HELOC may request an advance.

A HELOC agreement may contain provisions that restrict which borrowers may request an advance or require all borrowers to consent to the request.

§153.83. – *Reserved for future expansion*

§153.84.[9] 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, or similar device, or preprinted check unsolicited by the borrower 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 include prearranged drafts, preprinted checks requested by the borrower, 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) A borrower may from time to time specifically request preprinted checks for use in obtaining a HELOC advance but may not request the lender to periodically send preprinted checks to the borrower. A borrower may use a check reorder form, which may be included with preprinted checks, as a means of requesting a specific number of preprinted checks.

(3) An owner may, but is not required to, make in-person contact with the lender to request preprinted checks or to obtain a HELOC advance.

[9] Revised Interpretation §153.84 effective July 10, 2008.

Our Comment: (1) In the *ACORN* case summarized in Section II.H., the District Court declared the pre-2008 version of §153.84(1) invalid, holding that "convenience checks" are a similar device to a "credit card." The 2007 amendment to subsection 50(t)(3) deleted the words "preprinted solicitation checks" and inserted the words "preprinted check unsolicited by the borrower." In order to make §153.84 compatible with the 2007 amendment, in 2008 the Commissions amended §153.84(1) by removing the words "convenience checks" and inserting the words "preprinted checks requested by the borrower," made pre-2008 §153.84(2) part of new §153.84(3), and deleted pre-2008 §§153.84(3) and (4) as their respective definitions of "credit card" and "preprinted solicitation check" were made unnecessary by the 2007 amendment to subsection 50(t)(3). (2) For these reasons, the appellate court in the *ACORN* case, supra, reversed the District Court's order invalidating §153.84(1).

§153.85. Time the Extension of Credit is Established: Section 50(t)(4).

(a) 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 fees described in Section 50(a)(6)(E) 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.

(b) For the purpose of this section, the time the extension of credit is established for a HELOC refers to the date of closing. **Our Comment:** For the definition of "*closing*" refer to the definition contained in §153.1(3).

§153.86. Maximum Principal Amount Extended under a HELOC: Section 50(t)(5). 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 the maximum principal amount that may be extended under the account, when added to the aggregated total of the outstanding principal balances of all indebtedness secured by the homestead on the date the extension of credit is established, cannot

exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made. **Our Comment:** For the definition of "*fair market value*" refer to the definition contained in §153.1(9).

(1) At the time the initial or subsequent advance is made, the principal amount of the advance must comply with Section 50(t)(5). The following amounts when added together must be equal to or less than 80 percent of the fair market value:

(A) the amount of the advance;

(B) the amount of the principal balance of the HELOC at the time of the advance; and

(C) the principal balance outstanding of all other debts secured by the homestead on the date of the closing of the HELOC.

(2) An advance under Section 50(t)(5) must meet the requirements of Section 50(t)(2).

(3) The maximum principal balance of the HELOC that may be outstanding at any time must be determined on the date of closing and will not change through the term of the HELOC.

(4) For purposes of calculating the limits and thresholds under Section 50(t)(5) and (6), the outstanding principal balance of all other debts secured by the homestead is the principal balance outstanding of all other debts secured by the homestead on the date of the closing of the HELOC.

§153.87. Maximum Principal Amount of Additional Advances under a HELOC: Section 50(t)(6). 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 no additional debits or advances can be 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.

(1) A subsequent advance may be made only when the outstanding principal amount of the HELOC is 50 percent or less of the fair market value.

(2) A subsequent advance is prohibited if the outstanding principal amount of the HELOC exceeds 50 percent of the fair market value.

(3) If the outstanding principal amount exceeds 50 percent of the fair market value and then is repaid to an amount equal to or below the 50 percent of the fair market value, subsequent advances are permitted subject to the requirements of Section 50(t)(2) and (5).

§153.88. Repayment Terms of a HELOC: Section 50(t)(8).

(a) 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 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 during the period during which the owner may request advances, each installment equals or exceeds the amount of accrued interest; and after the period during which the owner may request advances, installments are substantially equal.

(b) Repayment of a HELOC is not required to begin until two months after the initial advance. For example, if an advance is not made at the time of closing, the repayment period is not required to begin until after the first advance. If there is no outstanding balance, then a payment is not required.

(c) Nothing in this section prohibits a borrower from voluntarily making payments on a schedule that is more frequent or earlier than is required by a lender.

Our Comment: As noted, the above HELOC Interpretations only interpret subsection 50(t). Subsection 50(t) does not cover every aspect of HELOC lending, and compliance with other applicable state and federal law and Texas constitutional provisions is required in making HELOC loans. One of the other constitutional provisions that must be

complied with in making a HELOC loan is subsection 50(a)(6). It is important that HELOC lenders familiarize themselves with those requirements of subsection 50(a)(6) and the Interpretations discussed in Section III.D.1. that are applicable to HELOC lending.

3. Home Equity Cure Provisions. Official Interpretations of subsection 50(a)(6)(Q)(x), approved by the Commissions pursuant to their authority under subsection 50(u), Article XVI, Texas Constitution and Sections 11.308 and 15.413 of the Finance Code, became effective November 11, 2004 for §§153.91, .92, .94, .95. and .96, and March 3, 2005 for §153.93. The Interpretations are contained in Chapter 153 of the Texas Administrative Code, 7 TAC §§153.91 - 153.96, and provide a legal "safe harbor" for an act or omission that conforms to an Interpretation in effect at the time of the act or omission. You may obtain a copy of the current Interpretations by accessing Title 7, Part 8, Chap. 153 of the Texas Administrative Code at:

http://info.sos.state.tx.us/pls/pub/readtac$ext.ViewTAC?tac_view=4&ti=7&pt=8&ch=153&rl=Y.

This Section III.D.3. republishes the current version of the above cited Interpretations and, where appropriate, also adds an **Our Comment** to point out our concerns and some problem areas:

§153.91. Adequate Notice of Failure to Comply.

(a) A borrower notifies a lender or holder of its alleged failure to comply with an obligation by taking reasonable steps to notify the lender or holder of the alleged failure to comply. The notification must include a reasonable:

(1) identification of the borrower;

(2) identification of the loan; and

(3) description of the alleged failure to comply.

(b) A borrower is not required to cite in the notification the section of the Constitution that the lender or holder allegedly violated.

Our Comment: (1) This Interpretation does not require the notice to be in writing. The Commissions' preamble to this Interpretation (*see,* November 5, 2004 issue of the *Texas Register*) states that the notice can be oral because "*the Constitution does not require that the notice be in writing.*" (2) This Interpretation does not expressly require the borrower to identify the loan as a home equity loan. In fact, the Commissions' preamble to this Interpretation states "[t]*he interpretation requires the borrower to identify the loan and that information should allow the lender to determine whether the loan is a home equity loan*." (3) See *Curry v. Bank of America* in Section II.F.1. for a case on an inadequate "description of the alleged failure to comply."

§153.92. Counting the 60-Day Cure Period.

(a) For purposes of Section 50(a)(6)(Q)(x), the day after the lender or holder receives the borrower's notification is day one of the 60-day period. All calendar days thereafter are counted up to day 60. If day 60 is a Sunday or federal legal public holiday, the period is extended to include the next day that is not a Sunday or federal legal public holiday.

(b) If the borrower provides the lender or holder inadequate notice, the 60-day period does not begin to run. **Our Comment:** See the *Curry* decision, *supra* in Section II.F.1, for a case on "inadequate notice."

§153.93. Methods of Notification.

(a) At closing, the lender or holder may make a reasonably conspicuous designation in writing of the location where the borrower may deliver a written or oral notice of a violation under 50(a)(6)(Q)(x) [*sic*]. The designation may include a mailing address, physical address, and telephone number. In addition, the lender or holder may designate an email address or other point of contact for delivery of a notice.

(b) If the lender or holder chooses to change the designated delivery location as provided in subsection (a) of this section, the address change does not become effective until the lender or holder sends conspicuous written notice of the address change to the borrower.

(c) The borrower may always deliver written notice to the registered agent of the lender or holder even if the lender or holder has named a delivery location.

(d) If the lender or holder does not designate a location where the borrower may deliver a notice of violation the borrower may deliver the notice to any physical address or mailing address of the lender or holder.

(e) Delivery of the notice by borrower to lender or holder's designated delivery location or registered agent by certified mail return receipt or other carrier delivery receipt, signed by the lender or holder, constitutes a rebuttable presumption of receipt by the lender or holder.

(f) If the borrower opts for a location or method of delivery other than set out in subsection (e), the borrower has the burden of proving that the location and method of delivery were reasonably calculated to put the lender or holder on notice of the default.

Our Comment: (1) This Interpretation permits the borrower's notice to be oral and does not require the notice, whether written or oral, to be made at the designated location in subsection (a). If the lender has designated a delivery location, the borrower may still notify the lender by delivering written notice to the lender's registered agent or by notifying the lender in any manner at another location of lender. In this latter case, the borrower has the burden of proving that effective delivery was made.

(2) This Interpretation does not require the lender to designate a delivery location, but if the lender does not designate a delivery location at closing, it is our belief that the lender may not do so at a later time. If the lender does designate a delivery location at closing, the lender should retain a copy of the written designation signed by the borrower. All future changes in location should be sent in a manner that allows for proof of delivery.

(3) There are advantages and disadvantages to providing and not providing a designated delivery location for notice of home equity violations. If the lender designates a delivery location, it is more likely the borrower will notify the lender at that location. Also, if the borrower delivers the notice to a location other than the designated location or the lender's registered agent, the borrower has the burden of proving effective delivery. The disadvantage is that the designated delivery location must be updated and conspicuous written notification be sent to the borrower each time the location changes (for example, when the loan is sold or the lender is no longer at that location), otherwise the borrower may continue to use the existing location for notification. If the lender does not designate a delivery location, the notice will always go to a current physical or mailing address of the lender or holder. The disadvantage is that the borrower is relieved of the burden of proving effective delivery.

(4) This Interpretation is silent on the issue of whether the loan servicer's address is a "physical address or mailing address of the lender or holder" if the loan servicer is an entity different from the lender or holder.

§153.94. Methods of Curing a Violation Under Section 50(a)(6)(Q)(x)(a) - (e).

(a) The lender or holder may correct a failure to comply under Section 50(a)(6)(Q)(x)(a) - (e), on or before the 60th day after the lender or holder receives the notice from an owner, if the lender or holder delivers required documents, notices, acknowledgements, or pays funds by:

(1) placing in the mail, placing with other delivery carrier, or delivering in person the required documents, notices, acknowledgements, or funds;

(2) crediting the amount to borrower's account; or

(3) using any other delivery method that the borrower agrees to in writing after the lender or holder receives the notice.

(b) The lender or holder has the burden of proving compliance with this section.

Our Comment: §153.91 does not require the borrower to provide a current address with the notice of lender's alleged failure to comply. Notwithstanding this oversight, the Commissions' preamble to §153.94 (*see,* November 5, 2004 issue of the *Texas Register*) states that "*the lender should act reasonably and use best efforts to communicate to the appropriate location of the borrower and with the appropriate number of borrowers, so that the borrower or borrowers, if more than one, have the best opportunity to receive information related to a potential violation of their home equity loan*." Thus, providing a cure or delivering a cure response to the last know address of a borrower or to less than all borrowers may not be sufficient to cure a violation.

§153.95.[10] Cure a Violation Under Section 50(a)(6)(Q)(x).

(a) If the lender or holder timely corrects a violation of Section 50(a)(6) as provided in Section 50(a)(6)(Q)(x), then the violation does not invalidate the lien.

(b) A lender or holder who complies with Section 50(a)(6)(Q)(x) to cure a violation before receiving notice of the violation from the borrower receives the same protection as if the lender had timely cured after receiving notice.

(c) A borrower's refusal to cooperate fully with an offer that complies with Section 50(a)(6)(Q)(x) to modify or refinance an equity loan does not invalidate the lender's protection for correcting a failure to comply.

[10] Revised Interpretation §153.95 effective November 13, 2008.

Our Comment: (1) This Interpretation provides that a lender's compliance with Section 50(a)(6)(Q)(x) or attempted compliance with Section 50(a)(6)(Q)(x) without borrower cooperation will preserve the validity of the lien. See also, *Doody v. Ameriquest Mortgage Co.*, supra in Section II.A.2., in which the Texas Supreme Court held that Section 50(a)(6)(Q)(x) not only operates as a cure provision, but also validates the home equity lien; and *Fix v. Flagstar Bank*, supra in Section II.F.3., in which the court held that the lender's offer to cure under Section 50(a)(6)(Q)(x), without borrower cooperation, satisfies the cure requirement. (2) According to the Commissions' preamble (*see,* November 5, 2004 issue of the *Texas Register*), a lender's use of §153.95(b) does not begin the 60-day cure time period.

§153.96. Correcting Failures Under Section 50(a)(6)(Q)(x)(f).

(a) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f), on or before the 60th day after the lender or holder receives the notice from the borrower the lender or holder may:

(1) refund or credit the $1,000 to the account of the borrower; and

(2) make an offer to modify or an offer to refinance the extension of credit on the terms provided in Section 50(a)(6)(Q)(x)(f) by placing the offer in the mail, other delivery carrier, or delivering the offer in person to the owner.

(b) To correct a failure to comply under Section 50(a)(6)(Q)(x)(f):

(1) the lender or holder has the option to either refund or credit $1,000; and

(2) the lender or holder and borrower may:

(A) modify the equity loan without completing the requirements of a refinance; or

(B) refinance with an extension of credit that complies with Section 50(a)(6).

(c) The lender or holder has the burden of proving compliance with this section.

(d) After the borrower accepts an offer to modify or refinance, the lender must make a good faith attempt to modify or refinance within a reasonable time not to exceed 90 days.

IV. POTENTIAL PROBLEM AREAS
A. Three Percent Cap

As noted in Section II.A., subsection 50(a)(6)(E) places a three percent limitation on fees paid by the owner or owner's spouse to any person in connection with an equity loan, the sole exception being interest. The Texas Finance Code, as interpreted by the Texas courts, defines interest. Texas decisions interpreting what is "interest" generally hold that a lender fee is interest unless the fee is for separate and additional consideration received other than for the loan of money. This means that in order not to be considered interest, a fee must be payment for actual services or goods provided other than the money loaned. If not "interest," the fee will be subject to the three percent fee cap of subsection 50(a)(6)(E). This controversy of what charges constitute fees subject to subsection 50(a)(6)(E) and what charges are interest excluded from the fee limitations of subsection 50(a)(6)(E) is a continuing issue for lenders, borrowers, the courts and the Commissions. Below are some examples.

1. Interpretation §153.5(3) states that "points" are interest and, therefore, outside the three percent fee cap of subsection 50(a)(6)(E), but §153.5(3) does not define the term "points." See the **Our Comment** discussion following §153.5(3) in Section III.D.1.

2. The *Tarver* and *Cerda* decisions discussed in Section II.A.5. hold that true discount points are interest and, thus, excluded from the three percent fee limitation of subsection 50(a)(6)(E). The *Breaux* case discussed in Section II.A.3 holds that certain other fees (which Texas courts ordinarily would not consider as interest) are interest; and the *Thomison* case discussed in Section II.A.4 holds that an origination fee (which under certain circumstances may be interest under Texas law) is not interest.

3. Interpretation §153.5(15) states that subsection 50(a)(6)(E) "*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*." (**emphasis added)** But also see revised Interpretation §153.14(2)(D), which states: *The 3% fee cap required by Section 50(a)(6)(E) applies to the original home equity loan and any subsequent modification as a single transaction.*

4. Interpretation §153.5(16) excludes hazard insurance premiums from the three percent fee limitation of subsection 50(a)(6)(E), as does the Fifth Circuit *Doody* case discussed in Section II.A.1.

5. In the *ACORN* case summarized in Section II.H., the appellate court affirmed the trial court's judgment invalidating Interpretations §§153.1(11) and 153.5(3), which define interest for home equity purposes. See Section II.H. for a discussion of the *ACORN* appellate court's decision invalidating §§153.1(11) and 153.5(3).

Without a clarifying constitutional amendment, the Commissions and the courts will continue to separately decide the issue of which charges are "fees" subject to subsection 50(a)(6)(E) and which charges are "interest" excluded from the three percent limitation of subsection 50(a)(60(E) - the Commissions by administrative interpretation of subsection 50(a)(6)(E), and the courts on a case-by-case basis under specific facts unique to the particular decision. Our recommendation is to treat all front-end charges (except per diem interest and true discount points) as fees subject to the three percent limitation of subsection 50(a)(6)(E).

B. Urban vs. Rural Homestead

See the discussion in Section III. A. 1 – 4 above, although this issue should have less importance now that Article XVI, Section 51, Texas Constitution, has been amended to increase the urban homestead to ten contiguous acres.

C. Copy Of All Documents

The 2007 amendment to subsection 50(a)(6)(Q)(v) and the companion 2008 revision to §153.22 of the Interpretations (*see* **Our Comment** (1) to §153.22 in Section III.D.1.*)* have resolved most of the issues raised by the previous version of subsection 50(a)(6)(Q)(v). In particular, it is now clear that only those documents executed by the owner at closing must be provided to the owner. Remember, also, that the T-42.1 Endorsement (*see* Section III.B.2.d.) insures that the closing agent provided the homestead

owner(s) with copies of all documents executed by said owner(s) at the title company office on the date of closing and that revised Interpretation §153.22 states that the lender is not required to give the homestead owner(s) "copies of documents that were signed by the owner prior to or after closing." However, one old issue remains and two new ones are raised by amended subsection 50(a)(6)(Q)(v):

(1) Does providing one copy of the documents to the homestead owner(s) suffice, or must each homestead owner be given a copy? Note that revised Interpretation §153.22 provides that one copy of the documents may be provided to married owners, the implication for non-married owners being that each non-married owner must receive his or her own copy.

(2) Do the copies have to be copies after the documents are executed or may they be copies of the documents before execution? As we noted in the **Our Comment** (2) to §153.22, we believe that the copies provided must be copies of the loan documents only after they are signed.

(3) What is meant by "final loan application"? See our explanation below.

In answer to these questions, we recommend: (1) Non-married owners each receive a copy of the documents. (2) The copies should be copies of the documents after they have been executed. (3) The final loan application usually is the version prepared by the lender and submitted at closing for the borrower to sign. In any event, it should always be the loan application relied upon by the lender and/or investor. For clarification, see §153.13(2) and **Our Comment** (3) in Section III.D.1.

D. Non-Titled Spouse

Is a non-titled spouse an "owner" of the homestead for home equity purposes? Under Texas law, "[h]omestead rights vest in both spouses regardless of whether the property is owned by both spouses, by one spouse separately, or even by a third party." *Rooms With A View, Inc. v. Private National Mortgage Association*, 7 S.W.3d 840 (Tex.App.–Austin 1999, pet. denied 2000), Certiorari Denied, 531 U.S. 826, 121 S.Ct. 72, 148 L.Ed.2d 36, 69 USLW 3002 (U.S.Tex. Oct 02, 2000) (NO. 99-2048), and cases cited therein; *Geldard v. Watson,* 214 S.W.3d 202 (Tex. App.–Texarkana, 2007). In Texas, the "homestead right constitutes an estate in land." *Laster v. First Huntsville Properties Co.*, 826 S.W.2d 125 (Tex. 1991); *Geldard v. Watson,* 214 S.W.3d 202 (Tex. App.–Texarkana, 2007). The homestead right of a surviving spouse has been held to be "one in the nature of a legal life estate…created by operation of law." *Williams v. Williams*, 569 S.W.2d 867 (Tex. 1978). Interpretation §153.1(13), discussed in Section III.D.1, defines "owner" as "[*a*] *person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead.*" Under Texas homestead law, a non-titled spouse has these rights. Thus, if the definition of "owner" in Interpretation §153.1(13) remains unchanged, we recommend that a non-titled spouse be treated the same as the titled owner for home equity purposes. For example, under subsection 50(a)(6) an "owner" is not only entitled to receive the 12-day notice required by subsection 50(g) but also a copy of the loan application and preclosing HUD-1 required by subsection 50(a)(6)(M)(ii) and must sign the acknowledgment of fair market value required by subsection 50(a)(6)(Q)(ix). In addition, we recommend that the non-borrowing spouse sign the loan application, in the capacity of "non-borrowing spouse," in order to comply with the loan application submission requirement of subsection 50(a)(6)(M)(i). Of course, it goes without saying, the non-titled spouse (whether considered an owner or not) also must sign the security instrument encumbering the homestead, the same as for any other loan secured by the homestead. *Article XVI, Section 50(c), Texas Constitution; Section 5.001, Texas Family Code; Geldard v. Watson,* 214 S.W.3d 202 (Tex. App.–Texarkana, 2007), and cases cited therein.

E. Voluntary Payment Of Non-Homestead Debt

Subsection 50(a)(6)(Q)(i) and Interpretation §153.18(1) provide that an equity loan cannot be conditioned upon the requirement that the homestead owner repay from the equity loan proceeds non-homestead debt owed to the equity lender. Instances have arisen, however, where the homestead owner has voluntarily requested that those debts be paid. Interpretation §153.18(2) states, "*[a]n 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.*" In this instance, we recommend that: (1) the equity lender obtain a signed acknowledgment from the owner documenting this voluntary payment; (2) the non-homestead

debt to the equity lender not be reflected on the HUD-1/1-A Settlement Statement; and (3) the equity loan proceeds for this voluntary payment be disbursed directly to the homestead owner and not be funded back to the equity lender by the title company closing the transaction. See also, *Box v. First State Bank, Bremond S.S.B.* in Section II.B.2. and **Our Comment** to §153.18 in Section III.D.1.

F. Acknowledgment Of Fair Market Value

Subsection 50(a)(6)(Q)(ix) requires that 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. A literal interpretation of this subsection could mean that the actual execution of the acknowledgment by the owner and the lender occur on the date the closing of the equity loan occurs (*see definitions in §153.1(3) and (6) in Section III.D.1)* rather than before or after that date. But taken in conjunction with the subsection 50(a)(6)(B) requirement that all debt (including the equity loan) against the homestead "*not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made,*" and the subsection 50(a)(6)(Q)(x)(d) cure provision that the lender can obtain the required signatures post-closing, the more reasoned interpretation is that "*on the date the extension of credit is made*" relates to the date of the fair market value, not the execution date of the acknowledgment of fair market value. That said, if the lender fails to sign the acknowledgment at or prior to closing, it is conceivable that a court could decide that the lender's signature is a requirement for consummation of the loan under federal rescission law (*see, §1026.23(a)(3) of Regulation Z*), thus extending the owner's federal right to cancel on the basis that consummation has not occurred until the lender signs the acknowledgment because a fully executed acknowledgment is required for loan validity under subsection 50(a)(6)(Q)(ix). The more immediate and real danger, however, is that if the lender fails to sign the acknowledgment at or prior to closing, the lender may fail to sign the acknowledgment after closing. In that event, if the owner notifies the lender of this failure and the lender does not take the appropriate action within 60 days, either because the lender does not know it received the notice or, if the loan has been sold, the originating lender cannot be contacted, the failure could void the loan (*see, subsections 50(a)(6)(Q)(x) and (x)(d)*). Although it may be operationally difficult, in order to avoid these problems, the safest procedure is to have the lender sign the acknowledgment of fair market value on or prior to the closing of the equity loan.

G. Contiguous Lots – Urban Homestead

The constitutional and statutory changes enlarging the urban homestead to 10 acres (*see Section III. A.1.*) added the requirement that if the urban homestead consists of more than one lot, the lots must be "contiguous." Prior to this change, the parcels of property comprising an urban homestead could be separated by distance, as long as they were in the same urban area. Does the word "contiguous" include "adjacent" (which does not require contact), or is it limited to "adjoining" or "contiguous" (which requires touching) in the sense of contact at some point no matter how small or on all or most of one side? The issue is whether physical contact is required and, if so, how much. From the following Texas Supreme Court cases, it appears that the Texas Supreme Court defines "contiguous" as requiring physical contact. See, *Ford v. Aetna Ins. Co.*, 424 S.W.2d 612 (Tex. 1968), [non-contiguous lots as business homestead] wherein the court stated that the two lots in question were not contiguous because they were separated by an alley and also separated laterally by a distance of 25 feet; *Railroad Commission of Texas v. Lone Star Gas Co.*, 587 S.W.2d 110 (Tex. 1979), [gas well spacing case under Railroad Commission rules] wherein the court held three tracts "contiguous" because the two outside tracts border on the middle tract; *City of Waco v. City of McGregor*, 523 S.W.2d 649 (Tex. 1975), [municipal annexation] wherein the court found that "the entire area of the attempted annexation is contiguous to McGregor since it is touching [*the city*] in a geographical sense"; *State ex rel. Pan Am. Production Co. v. Texas City*, 303 S.W.2d 780 (Tex. 1957), [municipal annexation] wherein the court held that the annexed land was "contiguous" with the city because they shared a common boundary line. The *Pan Am* court also stated that the term "adjacent" does not have a fixed or definite meaning and that "*the authorities are almost unanimous in according to that term the meaning of 'neighboring or close by' or 'in the vicinity of and not necessarily contiguous or touching upon'.*" Based on these cases, we believe the term "contiguous" for urban homestead purposes means the lots must physically touch one another.

H. Place Of Closing

The *Rooms With A View, Inc.* decision (herein "*Rooms*"), *supra* in Section IV.D., sheds some light on where an equity loan can close. In this case, the appellate court defined the term "title company" to mean "*a title insurer or an agent of a title insurer*" and held that "*[n]othing suggests the legislature intended 'title company' to refer to an entity performing only title abstractions.*" Although the *Rooms* case involved a home improvement loan under subsection 50(a)(5) and not an equity loan under subsection 50(a)(6), both subsections use the term "title company" in limiting the offices for either document execution (*home improvement contracts under subsection 50(a)(5)(D)*) or loan closing (*equity loans under subsection 50(a)(6)(N)*). The "lender" and "attorney at law" offices authorized by these subsections were not defined by the *Rooms* court and are subject to the same review and interpretation by the courts and the Commissions. If an equity loan is not closing at a title company, as defined by the *Rooms* case, we advise that the loan close only at the office of the lender funding the loan (not the broker) or a Texas licensed attorney at law. Please remember that Interpretation §153.15(1) requires that an equity loan closing must occur at the permanent physical address of the office or branch office of the title company, lender, or attorney.

V. RIGHT TO CURE

The 2003 amendments to subsection 50(a)(6)(Q)(x) added subparagraphs (a) through (f) to provide express provisions for a lender to cure a defect in a home equity loan not later than the 60th day after notification by the borrower to correct the defect, as follows: **(a)** paying to the owner an amount equal to any overcharge paid by the owner under or related to the loan if the owner has paid an amount that exceeds an amount stated in subsection 50(a)(6)(E) [*3% fee cap*], (G) [*prepayment penalty*], or (O) [*interest*]; **(b)** sending the owner a written acknowledgement that the lien is valid only in the amount that the loan does not exceed the percentage described by subsection 50(a)(6)(B) [*80% fair market value*] or is not secured by property described under subsections 50(a)(6)(H) [*additional collateral*] or (I) [*agricultural use tax exemption*]; **(c)** sending the owner a written notice modifying any other amount, percentage, term, or other provision prohibited by subsection 50(a)(6) 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 subsection 50(a)(6) and is not subject to any other term or provision prohibited by subsection 50(a)(6); **(d)** delivering the required documents to the borrower if the lender fails to comply with subsection 50(a)(6)(Q)(v) [*copy of owner-signed documents*] or obtaining the appropriate signatures if the lender fails to comply with subsection 50(a)(6)(Q)(ix) [*fair market value acknowledgement*]; **(e)** sending the owner a written acknowledgement that the accrual of interest and all of the owner's obligations under the loan are abated while any prior lien prohibited under subsection 50(a)(6)(K) [*home equity loan; reverse mortgage; home equity line of credit*] remains secured by the homestead; or **(f)** if the defect cannot be cured under subsections 50(a)(6)(Q)(x) (a) through (e), curing the defect by a refund or credit to the owner of $1,000 and offering to refinance the loan for the remaining term at no cost to the owner on the same terms, including interest, as the original loan with any modifications necessary to comply with section 50(a)(6), or on terms on which the owner and the lender otherwise agree that comply with subsection 50(a)(6). These 2003-added cure provisions expand and, at least in part, supersede the lender's right to cure authorized by the Texas Supreme Court *Doody* decision, *supra* in Section II.A.2.

We trust this memorandum is of some help in evaluating and mitigating the risks involved with home equity lending in Texas. Should you have any questions or desire further information, the attorneys and staff of this firm stand ready to assist you.

Attachment: Article XVI, Section 50, Texas Constitution, current to date.

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The Texas Constitution

Article 16 - GENERAL PROVISIONS

Section 50 - HOMESTEAD; PROTECTION FROM FORCED SALE; MORTGAGES, TRUST DEEDS, AND LIENS

(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 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) at the time the extension of credit is made, 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 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 REPAID 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 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, 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;
"(5) THE MAXIMUM PRINCIPAL AMOUNT THAT MAY BE EXTENDED, WHEN 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.

(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.

(*Amended Nov. 6, 1973, and Nov. 7, 1995; Subsecs. (a)-(d) amended and (e)-(s) added Nov. 4, 1997; Subsecs. (k), (p), and (r) amended Nov. 2, 1999; Subsec. (a) amended Nov. 6, 2001; Subsecs. (a), (f), and (g) amended and (t) and (u) added Sept. 13, 2003; Subsecs. (p) amended and (v) added Nov. 8, 2005; Subsecs. (a), (g) and (t) amended Nov. 6, 2007.*)