

Article

A Look Inside Texas' New Home Equity Loan Law

12.12.17

Law360

On Nov. 7, 2017, Texas voters approved the eighth series of amendments to the Texas constitutional provisions permitting loans secured by homestead equity. The 2017 amendments (authorized by Senate Joint Resolution 60) become effective for home equity loans made on or after Jan. 1, 2018. The amendments should help expand home equity loan opportunities, but the transition period requires compliance vigilance.

Texas is alone among the states in permitting home equity loans solely through its state constitution. This peculiarity originates from long-standing public policy dating back to when Texas was subject to Mexican law prior to Texas independence in 1836. When the Congress of the Republic of Texas in 1840 adopted the common law of England to replace Spanish civil law as applied in Mexico, existing homestead protections against general creditors were continued in effect by statute.^[1]

Texas law initially did not prevent consensual homestead liens, but loans secured by homesteads did not become prevalent until after the Civil War. Following the end of Reconstruction, Texas adopted its current constitution in 1876, which included for the first time a provision restricting consensual liens against homesteads except for purposes of purchase money or improvements made on the homestead. The restriction was deemed necessary to prevent a spouse from jeopardizing the family homestead as collateral for ill-advised loans. This law favoring the welfare of the family was one of the few exceptions to common law in Texas favoring individual freedom. As a result, for nearly 125 years after the enactment of the 1876 constitution, Texas homeowners faced the predicament of being forced to sell their homes as a means of accessing equity for reasons other than purchase money and home improvements even when it was not otherwise desirable for owners to sell. Not surprisingly, real estate agents favored the restrictive policy while banks loathed it.

By the latter half of the 20th century, Texas was the only state prohibiting general purpose home equity loans. The compromise that eventually loosened the restriction was not reached until 1997 with the enactment of home equity loan legislation codified in Section 50, Article XVI of the Texas Constitution. This law imposes a multitude of disclosures, conditions and limitations from origination to foreclosure, including the codification of the law in the constitution itself as a means of making it more difficult to amend in the future. Constitutional amendments require two-thirds vote of the Legislature and statewide voter approval. Texan voters approved the amendments in 1997 and home equity loans under this law commenced on Jan. 1, 1998. Since then, through 2017, voters have approved amendments eight times.

2017 Amendments

Six changes to the home equity loan law were made by the 2017 amendments:

1. Removal of Certain Financed Expenses From the Cap on Financed Expenses and Lowering the Cap.^[2]

When the home equity law was enacted in 1997, any fees necessary to originate, evaluate, maintain, record, insure or service the extension of credit (other than interest) was limited to 3 percent of the original principal

amount of the loan. Much litigation ensued over what constituted “interest” and allowable fees. In addition, certain mandatory expenses often made it impractical to make a home equity loan for an amount less than \$100,000. The 2017 amendments addressed this issue by lowering the fee cap to 2 percent of the original principal and clarifying that “bona fide discount points used to buy down the interest rate” are to be treated the same way as “interest” (i.e., such discount points are excluded from the 2 percent cap). In addition, the amendments specify four types of fees excluded from the fee cap, including (1) the cost of an appraisal performed by a third-party appraiser, (2) a property survey performed by a state-registered or licensed surveyor, (3) a state base premium for a mortgage policy of title insurance with endorsements established in accordance with state law, or (4) a title examination report if its cost is less than the state base premium for a mortgage policy of title insurance without endorsements established in accordance with state law.

2. Authority to Make Home Equity Loans on Property Designated for Agricultural Use.[3]

Since 1997, a home equity loan has been impermissible on property designated for agricultural use unless the property was used primarily for the production of milk. This limitation will now be removed, thereby allowing home equity loans for the first time on homesteads designated for agricultural use even if the property is not used primarily for the production of milk.

3. Financial Institution Subsidiaries and Mortgage Bankers or Mortgage Companies Permitted to Make Home Equity Loans.[4]

Only certain entities and persons are permitted to make a home equity loan. Among those permitted are banks, savings and loan associations, savings banks, and credit unions doing business under the laws of Texas or the United States. The 2017 amendments will permit subsidiaries of these financial institutions to make home equity loans for the first time. In addition, the current provision allowing a “mortgage broker” to make a home equity loan was changed to permit a “mortgage banker or mortgage company” to make these loans.

4. Expanded Options for Refinancing Home Equity Loans.[5]

Under current law it is not possible to refinance a home equity loan unless the refinancing loan is itself a new home equity loan or a reverse mortgage permitted by the constitution. The 2017 amendments for the first time will permit a refinancing loan that does not qualify as a home equity loan or reverse mortgage, but only if four conditions are satisfied. These include (1) the refinancing cannot occur prior to the first one-year anniversary of the home equity loan, (2) the refinancing does not include the advancement of any additional funds except funds advanced to refinance a debt secured by a homestead lien as permitted under the Texas Constitution or the actual costs and reserves required by the lender to refinance the loan, (3) the refinanced debt is subject to an 80 percent loan to fair market value test as of the closing date with respect to all other debt secured by a valid lien on the homestead, and (4) the lender provides a detailed written disclosure notice, as set forth in the amendments, on a separate document not later than the third business day after the date the owner submits the loan application to the lender and at least 12 days before the refinancing loan is closed. The new refinancing provisions are significant because the ability to convert a home equity loan into a mortgage loan that is not subject to the restrictions of a home equity loan will likely permit refinancing at lower interest rates, but without the foreclosure and other protections afforded to home equity loans.

5. Revision to Required Home Equity Loan Disclosure.[6]

The 2017 amendments revise the constitution’s required 12-day disclosure form before a home equity loan can be originated. The revised form incorporates the changes made by the 2017 amendments.

6. Home Equity Line of Credit Limitation on Advances Modified.[7]

Under current law, any single debit or advance under a home equity line of credit must be at least \$4,000, the maximum amount of a home equity line of credit, when added to the aggregate total of the outstanding principal of all debt secured by the homestead on the date the extension of credit is established, cannot exceed 80 percent of the fair market value of the loan, and 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 when the credit is established. The 2017 amendments maintain the \$4,000 required draw and 80 percent loan-to-value ratio, but eliminate the 50 percent loan-to-value ratio for additional debits or advances. This change makes the loan-to-value ratio for home equity lines of credit consistent with closed-end home equity loans.

Administrative Interpretations and Transition

Beginning with constitutional amendments adopted in 2003, a provision in the home equity loan law permits the Legislature by statute to delegate to one or more state agencies the power to interpret the home equity loan law. These interpretations can be relied upon by qualified home equity loan lenders as a safe harbor when facing legal actions relating to the application of the constitution's text to specific facts. The legislature delegated this authority to the Finance Commission of Texas and the Texas Credit Union Commission.[8] In anticipation of voter adoption of the 2017 amendments, these agencies jointly issued proposed amendments to their interpretations found in Title 7 of the Texas Administrative Code, Chapter 153, but the proposals were not published in the Texas Register until Nov. 24, 2017. As a result, the amendments will not be effective simultaneously with the effective date of the constitutional amendments. The agencies will consider comments received through Dec. 25, 2017.[9] These agencies also issued a "Statement on Passage of SJR 60" indicating that the anticipated adoption of the interpretations will be considered on Feb. 18, 2018, with a final effective date in late March 2018.[10]

The required 12-day disclosure period before a home equity loan can be closed, coupled with the delayed effective date of the regulatory interpretations, poses compliance challenges. For example, the joint statement advises that a prior attorney general opinion indicates that the safest course for lenders is to wait until Jan. 1, 2018, before providing the new version of the 12-day disclosure notice. Thus, the earliest date a closing could occur under the 2017 amendments is Jan. 13, 2018, assuming the new notice is given on Jan. 1, 2018. The new disclosure also has implications for home equity loans made in December 2017 under existing law. For these loans, the Texas Bankers Association has advised lenders that the last day to send their 12-day disclosure notice is Dec. 19, 2017, for a Dec. 31, 2017 closing date, with the disclosures and fee cap under current law.[11]

Finally, the delay between the effective date of the constitutional amendments on Jan. 1, 2018, and the anticipated effective date of the regulatory interpretations in late March 2018 means that the interpretations will not receive the constitutional civil litigation "safe harbor" for lenders relying on the interpretations during the intervening period. In other words, it is possible that a court could determine that a particular interpretation was not in conformity with the constitution for loans made after Jan. 1, 2018, and prior to the effective date of the interpretations. The joint statement, however, does provide some regulatory comfort in that the agencies have stated that they will not take any action against a lender for violating the new constitutional amendments for home equity loans made after Jan. 1, 2018, and prior to the effective date of the interpretations if the lender is in compliance with the proposed interpretations during the interval. Accordingly, at a minimum, home equity lenders should familiarize themselves with the interpretations and treat them as applicable on and after Jan. 1, 2018, even though they will not become final until March 2018, with the caveat that the interpretations as proposed on Nov. 25 might be modified as a consequence of comments received by the agencies prior to Dec. 25.

Jeff Dunn is a shareholder at Munsch Hardt Kopf & Harr PC in the firm's Dallas office. His practice area includes consumer finance regulatory compliance, payments law and corporate finance.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] The 1840 law adopting the common law of England as the rule of decision in Texas except when displaced by statute or the constitution remains codified today. See Texas Civil Practice and Remedies Code § 5.001.

[2] Texas Constitution, Art. XVI, § 50(a)(6)(E).

[3] Id., § 50(a)(6)(I).

[4] Id., § 50(a)(6)(P).

[5] Id., § 50(f).

[6] Id., § 50(g).

[7] Id., § 50(t)(6).

[8] Id., § 50(u), and Texas Finance Code § 11.308 and § 15.43.

[9] 42 Texas Register 6580-6587 (Nov. 24, 2017).

[10] State of Texas Joint Financial Regulatory Agencies, "Statement on Passage of SJR 60" (Nov. 15, 2017), accessible at <https://www.fc.texas.gov/homeinfo/homeinfo.html>.

[11] A video produced by the Texas Bankers Association explains the 12-day disclosure period for the latest possible 2017 home equity loans and the earliest possible 2018 home equity loans. See <https://vimeo.com/245085049>.

Primary Contacts



Jeffrey Dunn

Dallas
214.855.7588
jdunn@munsch.com

Related Practices

Finance

Related Industries

Financial Services