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McGlinchey Stafford and Youngblood & Associates PLLC

CLIENT ALERT

Texas Legislature Passes Home Equity Amendments

On May 6, 2017, both houses of the Texas Legislature passed Senate Joint Resolution 60 (SJR 60), proposing Texas Constitutional amendments to current requirements for home equity lending. The amendments will be on the ballot for the November, 2017 statewide election and if approved, will take effect January 1, 2018. The amendments address the following areas of existing home equity requirements:

Limitation on Closing Costs

The current Constitution limits to three percent of the loan amount the total of fees that an owner or owner's spouse can pay, in addition to interest, 'necessary to originate, evaluate, maintain, record, insure, or service' the home equity loan. In practice these fees are usually found in the Loan Costs section of the second page of the federal Closing Disclosure (Closing Cost Details), plus recording fees from subsection E. and any other costs required by the lender from subsection H. of the Other Costs section. Lenders are allowed to exclude interest from the fee calculation, including per-diem interest and bona-fide discount points charged at closing. Fees that the borrower opts to pay, such as an owner's title policy or dues or membership fees in a homeowners' association, are excluded from the fee calculation because they are not 'necessary' or required by the lender in order to close the loan.

In an effort to promote home equity lending with smaller loan amounts, SJR 60 lowers the fee cap from three percent to two percent, but allows lenders to exclude fees for a third-party appraisal, survey and lender's title coverage up to the amount to the state-promulgated base premium amount, plus cost of endorsements. Lenders may also exclude a fee for a title examination report (if used instead of a lender's title policy and its cost is less). If the borrower pays a discounted title insurance premium because of a refinance discount set by statute, it is our interpretation that only the discounted premium should be excluded. Note that the exclusions in SJR 60 do not extend to fees related to but separate from excluded fees, so that appraisal

management company, appraisal management software or in-house appraiser fees, title company guaranty fees and tax deletion fees, for example, are still included in the fee calculation.

Agricultural Valuation Permitted

If approved in the November vote, effective for home equity loans made on or after January 1, 2018, there will be no prohibition on homestead collateral designated for agricultural use for property tax purposes. Since there will be no violation for loans closed after that date with agricultural value for tax purposes, the cure for that violation will also be removed. This change puts farm and ranch owners on an even footing with dairy owners, who have been able to obtain home equity loans on homesteads used as dairies since 1997.

Rate-and-Term Refinance of Home Equity Loan Permitted

Perhaps the most repeated of the current rules is 'once a home equity loan, always a home equity loan.' Once it takes effect, SJR 60 allows a lender to refinance a home equity loan or reverse mortgage as a rate-and-term refinance, but only if the following requirements are met: the new loan may not close before the first anniversary of the home equity loan, and there are no new funds advanced, other than the payoff of one or more valid liens on the homestead plus 'actual costs and reserves' required by the lender to close the refinance (note the slightly different language from 'reasonable costs necessary to refinance such debt' allowed for a rate-and-term refinance of other permissible types of homestead debt). There is also a requirement for the lender to deliver a new rate-and-term refinance twelve-day cooling off notice, described below. Lenders will have to develop a process to take applications for a rate-and-term refinance of a home equity loan, and then to deliver the correct twelve-day notice and determine whether a rate-and term refinance is appropriate.

SJR 60 refers to an affidavit that can be signed by the owner or the owner's spouse acknowledging that the requirements above were met. If it is signed, it conclusively establishes that the requirements above were met, so that the new loan will be a valid rate-and-term refinance lien under the Constitution. Because of its conclusive value, we expect this affidavit to become an industry best practice and likely an investor requirement as well.

Authorized Lenders

SJR 60 adds to the list of entities permitted to make home equity extensions of credit mortgage bankers registered under Chapter 157 of the Finance Code, mortgage loan companies registered under Chapter 156 of the Finance Code, and subsidiaries of Texas or federal-chartered financial institutions such as banks, savings and loans, savings banks or credit unions. Under current law these entities probably have existing authority under another of the permitted entities, such as an entity with federal approval as a Fannie Mae, Freddie Mac, FHA, VA or USDA mortgagee.

HELOC Advance Limit

The Constitution currently prohibits further advances under a home equity line of credit (HELOC) if the loan-to-value ratio is greater than fifty percent. SJR 60 raises that limit to match the closed-end home equity loan loan-to-value limit of eighty percent. The twelve-day notice to be used in 2018 and later reflects this change. Lenders servicing HELOCs may have to develop

servicing procedures that permits advances to these different loan-to-value limits based on date of origination.

Twelve-Day Notices

Effective for loans closed on or after January 1, 2018, the twelve-day 'cooling off' notice will reflect the amendment changes, including the new closing cost fee calculation and exclusions, removal of the agricultural valuation prohibition, and higher HELOC loan-to-value limit for advances. Because of a 1997 Texas Attorney General Opinion (No. DM-452), lenders may not deliver the new twelve-day notice required under the amendment until on or after the effective date of the amendment. As a result, lenders will need to either close home equity loans in process with the current twelve-day notice before the expiration of the current home equity requirements at the end of 2017, or re-disclose the new twelve-day notice on or after January 1, 2018, wait the required cooling-off period, and then close. In any event, no home equity loans will close from January 1 through January 12, 2018.

The rate-and-term twelve-day notice gives the requirements for a rate-and-term refinance described above, and further warns the homestead owner that the consumer protections of home equity loan will not apply to the new rate-and-term refinance. For example, the new loan may be foreclosed by non-judicial power of sale foreclosure, may have personal recourse on the owners, and may have other terms not permitted in a home equity transaction.

As with the home equity twelve-day notice, the new twelve-day cooling-off notice to be delivered before closing a rate-and-term refinance of a home equity loan should not be delivered before the amendment that creates it takes effect on January 1, 2018. As with the home equity twelve-day notice, lenders will not be able to close any home equity to rate-and-term refinances from January 1, 2018 through January 12, 2018.

Please note that a rate-and-term twelve-day notice is not effective as a home equity twelve-day notice, and vice versa. Lenders will have to make it clear to borrowers what loan type they have applied for, and what type is being disclosed. Until there is more industry consensus and perhaps guidance from the Texas Finance Commission, we do not recommend a work-around, such as delivering both 12-day notices and then deciding with the borrower later which one applies.

If you have any questions or comments concerning this Client Alert, please do not hesitate to contact:

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*Not Certified by the Texas Board of Legal Specialization

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