

LOAN WORKSHEET #10 – HOME EQUITY LENDING

OVERVIEW

Home equity lending in Texas was allowed by an amendment to the Texas Constitution approved by the voters on November 4, 1997 and became effective January 1, 1998. On November 2, 1999, Texas voters approved changes that corrected problems with reverse mortgages and the size of an urban homestead. Further changes to the Texas Constitution were approved by the voters on September 13, 2003. These changes authorize home equity lines of credit, allow lenders under certain conditions to cure violations of the home equity lending law and enable borrowers to refinance home equity loans with a reverse mortgage. This amendment also permits the Finance Commission and Credit Union Commission to issue interpretations of home equity lending provisions at the request of an interested party or on their own motion. On November 6, 2007, Texas voters approved additional changes to the Texas Constitution which modified procedures and changed the deadline for designating property as agricultural.

Most recent changes to Article 16, Section 50 of the Texas Constitution occurred on November 7, 2017 when Texas voters again approved changes to home equity lending laws. The changes which became effective January 1, 2018 lower the fee cap limitation from 3% to 2% and exclude certain additional fees from counting towards this cap. Additionally, the amendments authorized the refinancing of a seasoned home equity loan into a non-home equity/conventional loan; and increase the equity provision to 80% on home equity lines of credit. The amendments also allow farm and ranch property owners to acquire home equity loans; however, a related statutory provision, Tax Code §23.42(a-1), remains in effect which prohibits land to be designated for agricultural use if the land secures a home equity loan described by Section 50(a)(6), Article XVI, Texas Constitution. Legislation has been introduced in 2019 to correct this problem. If passed this will take effect January 1, 2020. The amendment also expanded the authority for not only banks, savings and loan associations, savings banks, and credit unions to make a home equity loan, but also any subsidiary of these entities or a mortgage banker or mortgage company to originate such.

Home equity loans are defined as loans that are collateralized by a non-purchase money mortgage or deed of trust on the borrower's principal residence. The borrower's equity, relative to the value of the residence, provides protection for the loan and determines the maximum amount of credit that may be advanced. Traditionally, home equity loans have been used to fund home improvements or consolidate debt, however, their popularity has expanded considerably. Uses now include consumer purchases, personal investments, working capital for small business, and a supplement to personal income.

Although home equity lending has existed for many years in other states, home equity loans made under Texas law will differ from these in two major respects:

- 1) The borrower may not be held personally liable for repayment of the loans; and
- 2) The bank may forfeit principal and interest if it fails to comply with the many requirements of the enabling Constitutional Amendment and is not able to cure the violation under Section (6)(Q)(x).

Because provisions of the Texas Constitution related to home equity lending have significant penalties to the lender for non-compliance, it will be necessary to evaluate the institution's

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compliance to the constitutional provision to adequately assess risk. Although many of the following procedures have characteristics of consumer compliance procedures, in reality, the primary focus is one of safety and soundness. In addition, a complying loan does not necessarily mean that a loan will be considered low-risk by the examiners. Repayment capacity and history, collateral value and position, and all other traditional measures of loan quality will also be assessed. Although they share many attributes with consumer loans and may be administered by a bank’s consumer loan department, home equity loans will be individually sampled by examiners and should be reported in the call report as “loans secured by 1-4 family residential property.”

For further guidance and interpretation refer to [Article 16](#), Section 50 of the Texas Constitution and Chapters 151, 152, and 153 of [Title 7, Part 8](#) of the Texas Administrative Code.

Home Equity Loans, Reverse Mortgages Home Improvement Loans, Home Equity Lines of Credit, and Refinances of Home Equity Loans

Evaluate	Comments
<p>Policies and Procedures</p> <p><i>Review the bank’s home equity policies and procedures to determine:</i></p> <p>_____ 1. Does the bank have a board approved policy for making and administering home equity and reverse mortgage loans?</p> <p>_____ 2. Is the bank’s documentation and funding system adequate to ensure full compliance with all aspects of the law prior to funding?</p> <p>_____ 3. What are the underwriting criteria in the policy? Is it consistent with the risk associated with this type of lending?</p> <p>_____ 4. What are the policy’s debt-to-income and debt service guidelines?</p>	

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Evaluate	Comments
<p>_____ 5. What policy limits have been established to limit aggregate exposure to superior liens?</p>	
<p>_____ 6. Has the board established a limit on the overall business line? What is the limit? Does it seem reasonable?</p>	
<p>_____ 7. How has the bank set loan pricing? Has it considered and calculated the cost of collection in the event of default?</p>	
<p>_____ 8. What is the bank's collection policy? Does it evaluate the cost/benefit aspect of acquiring a superior lien?</p>	
<p>_____ 9. Does the bank offer open-end lines of credit as described in Section 50(t) of the Constitution?</p>	
<p>_____ 10. How will the bank monitor the property value? Ensure that policy does not deviate from Section 50(a)(6)(J) which prohibits the bank from accelerating the loan or collecting additional monies if the collateral value declines.</p>	
<p>_____ 11. Does policy prohibit the lender from taking an assignment of wages as security for the home equity loan as per 50(a)(6)(Q)(ii).</p>	

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<p>Home Equity Requirements</p> <p><i>Review a sample of loans to determine compliance with the enabling constitutional amendment, Article 16, Section 50.</i></p> <p>_____ 1. Is the property agriculture related? If so, it is ineligible for a home equity loan unless it is a dairy. Although 50(a)(6)(I) allows for home equity loans secured by agricultural property, the Tax Code §23.42(a-1) does not. A bill has been filed for the 86th Legislature (2019) to consider which will correct this issue.</p> <p>_____ 2. Are there any other encumbrances against the property? Review title policy to ensure no other home equity liens under this statute exist. 50(a)(6)(K).</p> <p>_____ 3. Does the property have an independent appraisal or evaluation of fair market value? 50(h)(1) and (2).</p> <ul style="list-style-type: none"> • Does the valuation comply with Part 323 and federal guidelines on evaluations (Interagency Appraisal Evaluation Guidelines dated 12-2-2010)? <p>_____ 4. Did all parties (lender and borrower(s)) sign a written acknowledgment of the property's fair market value? 50(a)(6)(Q)(ix).</p>	

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<p>_____ 5. Is bank in compliance with a maximum LTV of 80% as per 50(a)(6)(B)?</p>	
<p>_____ 6. Were fees charged at or below 2% as per 50(a)(6)(E)?</p>	
<p>_____ 7. Did the bank wait at least 12 calendar days after the application was received and one business day after the borrower receives a final itemized disclosure of fee before closing the loan? 50(a)(6)(M).</p>	
<p>_____ 8. Was the closing held at the bank? Law office? Title company? The closing cannot be held anywhere other than the above. 50(a)(6)(N).</p>	
<p>_____ 9. Did the bank wait three days after closing to fund the loan, as per 50(a)(6)(Q)(viii)?</p>	
<p>_____ 10. Was the loan made without recourse to the borrower, as per 50(a)(6)(C)?</p>	
<p>_____ 11. The bank is prohibited from securing the loan with any other real or personal property (including guarantees) besides the homestead. Did the bank comply with this? 50(a)(6)(H).</p>	

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<p>_____ 12. As per Section 50(a)(6)(Q)(I), the owner of the homestead may not be required to apply the proceeds of the extension of credit to repay another debt, except debts secured by the homestead or debt to another lender. If a portion of the loan proceeds went to repay other debt, is there a signed acknowledgment from the borrower evidencing that this action was voluntary?</p>	
<p>_____ 13. Is there is any owner or an owner's spouse that is not a maker on the note? If so, has the bank obtained an acknowledgement of that person's consent to the mortgage? 50(a)(6)(A).</p>	
<p>_____ 14. Can the loan be paid in advance without penalty or fee? 50(a)(6)(G).</p>	
<p>_____ 15. Does the loan amortize in substantially equal successive monthly installments (not more often than every 14 days and not less often than monthly) beginning no later than two months from the date of the extension of credit? 50(a)(6)(L).</p> <ul style="list-style-type: none"> • No balloon payment • No negative amortization 	

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<p>_____ 16. Is there evidence that the lender provided the “notice” (the text of the notice is in the constitutional amendment) at least 12 days before closing? 50(g).</p> <p>_____ 17. Did the owner sign or execute any documents evidencing a home equity transaction that contains any blanks (besides signature blocks)? 50(a)(6)(Q)(iii).</p> <p>_____ 18. Is there any evidence that the lender did not provide the owner(s) a copy of all documents evidencing the home equity transaction at the time the extension of credit was made? 50(a)(6)(Q)(v).</p> <p>Reverse Mortgages</p> <p>Does the bank offer reverse mortgage loans? If yes, complete this section.</p> <p><i>A reverse mortgage is an extension of credit under which advances are provided to the borrower based on the equity in the borrower’s homestead. The loan is not repaid until all borrowers have died, the homestead is sold, or vacated for longer than 12 months without prior written approval of the lender.</i></p> <p><i>Review a sample of loans to determine compliance with the enabling constitutional amendment, Article 16, Section 50.</i></p> <p>_____ 1. Is the borrower at least 62 years of age? 50(k)(2).</p>	

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<p>_____ 2. Is the mortgage in writing and appear to be voluntary? 50(k)(1).</p>	
<p>_____ 3. Is there evidence that the borrower received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives? 50(k)(8).</p>	
<p>_____ 4. Was the loan made without recourse to the owner and owner's spouse? 50(k)(3).</p>	
<p>_____ 5. Did the bank advance funds by a method other than a credit card, debit card, preprinted solicitation check, or similar device? 50(v)(1).</p>	
<p>_____ 6. Did the bank collect the loan fees at the inception of the loan? Fees may not be charged in connection with any advance. 50(v)(2).</p>	
<p>_____ 7. If the loan is fully funded:</p> <ul style="list-style-type: none"> • What is the projected time frame for repayment? • Is it still accruing interest? • Does the collateral value cover both interest and outstanding principal? 	

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<p>Home Improvement Loans</p> <p>Does the bank offer home improvement loans? If yes, complete this section.</p> <p><i>Although these loans do not have to meet all the foregoing criteria for home equity or reverse mortgage loans, the following provisions do apply.</i></p> <p><i>Review a sample of loans to determine compliance with the enabling constitutional amendment, Article 16, Section 50.</i></p> <p>_____ 1. Did the bank wait at least five calendar days after the application was received before closing the loan? 50(a)(5)(B).</p> <p>_____ 2. Did the bank wait three days after closing to fund the loan? 50(a)(5)(C).</p> <p>_____ 3. Was the closing held at the bank? Law office? Title company? The closing cannot be held anywhere other than the above. 50(a)(5)(D).</p>	

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<p>Lines of Credit</p> <p>Does the bank offer home equity lines of credit (HELOC)? If yes, complete this section.</p> <p><i>The constitutional amendment passed on September 13, 2003, allows banks to offer home equity lines of credit. But, it imposes several restrictions. In addition to the other restrictions imposed on typical home equity loans, examiners should review the following provisions.</i></p> <p><i>Review a sample of loans to determine compliance with the enabling constitutional amendment, Article 16, Section 50.</i></p> <p>_____ 1. Are advances in increments of not less than \$4,000? 50(t)(2).</p> <p>_____ 2. Did the bank advance funds by a method other than a credit card, debit card, preprinted solicitation check, or similar device? 50(t)(3).</p> <p>_____ 3. Did the bank collect the loan fees at the inception of the loan? Fees may not be charged in connection with any advance. 50(t)(4).</p> <p>_____ 4. Does the loan require payments not more often than every 14 days and not less often than monthly, beginning not later than two months after the extension of credit is established? Repayment is not required until two months after the initial advance. 50(t)(8).</p>	

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<p>_____ 5. Does the bank ensure that no additional debits or advances are made if the total principal amount outstanding exceeds an amount equal to 80 percent of the fair market value of the homestead as determined on the date the account is established? 50(a)(6)(B)?</p> <p>Refinance Home Equity Loan to Conventional Loan</p> <p><i>Per constitutional amendment approved on November 7, 2017, banks are allowed to refinance a seasoned home equity loan into a non-home equity/conventional loan. Refer to Article 16, Section 50 (f) and (f-1)</i></p> <p>_____ 1. Did the refinanced loan close after the first anniversary since the home equity loan was closed? 50(f)(2)(A)</p> <p>_____ 2. Does the bank ensure that the refinanced extension of credit does not include the advance of any additional funds other than relevant closing costs to refinance a debt? 50(f)(2)(B)(ii)</p> <p>_____ 3. Does the bank ensure that the new principle amount does not exceed 80% of the property's fair market value? 50(a)(6)(B)</p>	

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<p>_____ 4. Is there evidence that the bank provided the written notice in 50(f)(2)(D) no later than the third business day after the loan application is submitted to the lender and at least 12 days before the date the refinance of the extension of credit is closed?</p> <p>_____ 5. Did the owner or the owner's spouse sign an affidavit acknowledging that the requirements of 50(f)(2) regarding refinancing have been met? 50(f-1)</p>	