

- SUBJECT:** Enabling legislation for home equity loans
- COMMITTEE:** Financial Institutions — committee substitute recommended
- VOTE:** 8 ayes — Marchant, Gutierrez, Ehrhardt, Elkins, Grusendorf, Patterson, Smith, Solomons
- 0 nays
- 1 absent — Giddings
- WITNESSES:** (See analysis of HJR 31)
- BACKGROUND :** The Texas Constitution prohibits the forced sale of a person's homestead to repay debts, except for a debt for the purchase price of a home; to finance improvements to the home; for local property taxes and homeowner's federal taxes; and a court-ordered partition of the property, called an owelty of partition. Equity is the difference between a home's market value and what is owed on the home.
- DIGEST:** CSHB 1188 would allow encumbrances to be fixed on homestead property for equity loans and extensions of credit and would establish rules and guidelines for these loans.
- CSHB 1188 would take effect January 1, 1998, if HJR 31 were approved by the voters.
- Extensions of credit.** Extensions of credit could be for any purpose as long as the extension was the only debt secured by the homestead. Prior debt on the homestead would have to be paid in full or refinanced as part of an extension of credit. Creditors could not require that extensions of credit be used for particular purposes.
- Equity loans.** HB 1188 would define equity loans as extensions of credit that are secured by a voluntary lien on a homestead or other consensual security interest in a homestead. A home owner could have only one home equity loan at a time, and the loan could not be secured by any additional

real or personal property, except for a manufactured home or rents to be derived from the homestead. The loan would have to be made with the consent of each owner and the spouse of each owner.

Total outstanding debt secured by a homestead, including the principal of an equity loan and any other indebtedness secured by encumbrances on the homestead, could not exceed 75 percent of the fair market value of the homestead. The bill would establish methods for determining the homestead's fair market value. Advances made by the lender to protect a lien on the homestead, including hazard insurance premiums, repairs or payments on a previous loan secured by the homestead, would not be counted toward the 75 percent cap.

The loan would have to be scheduled to be repaid in substantially equal monthly payments beginning no later than two months after the loan was made. The payments would have to equal the amount of interest and principal scheduled to accrue as of the payment date or that would accrue as of the payment date if the loan and interest were to be fully amortized.

The loans would have to be made by banks, savings and loan associations, savings banks, credit unions, federally chartered lending instrumentalities or persons federally approved as mortgagees to make federally insured loans or persons licensed to make regulated loans.

Lenders could charge any fixed or variable rate of interest that did not exceed that authorized under Texas statutes governing interest.

Upon default, if loan holders elected to sell the property, they would have to send the borrower written notice of the default by certified mail. The lien holder could not give the borrower the standard notice required under the Property Code about the sale of property under a contract lien until the borrower was given at least 30 days after receiving the written notice to cure the default. Upon default, the holder of an equity loan would be prohibited from seeking recourse against the assets of the borrower, other than the property securing the loan, unless the loan holder had obtained a judicial foreclosure of the lien in district court.

Equity loans could not be closed before the 12th day after the lender received a loan application, and each owner or owner's spouse could rescind a loan. The right to rescind a loan could not be waived.

Lenders could request borrowers to provide the same types and amounts of insurance that can be required under law for secondary mortgages, under federal housing insurance programs or under any state or federal statute authorizing or requiring insurance for loans relating to credit extensions

**Reverse Mortgages.** Reverse mortgages would be considered extensions of credit. They would have to be based on a home owner's equity in a house and secured by a voluntary lien on a homestead or other consensual security interest that would not be due until the homestead securing the loan was sold or all borrowers quit using the homestead as a principal residence for more than 180 consecutive days and the location of the owner was unknown to the lender.

The loan would have to be made with all owners' and their spouses' consent. Reverse mortgages would be nonrecourse — upon default, the holder of a reverse mortgage would be prohibited from seeking recourse against the personal assets of a borrower. Lenders would be prohibited from reducing the amount or number of periodic advances because of an adjustment in interest rates.

Interest rates could be fixed or adjustable, or interest could be contingent on appreciation in the homestead's market value.

If a reverse mortgage involved periodic advances to borrowers, the advances could not be reduced in number or amount because of an adjustment in the interest rate. Lenders that did not make required loan advances and did not cure the situation would forfeit any right to collect all interest.

Reverse mortgages could be made without regard to other state or federal laws concerning conditions such as the purpose and uses of advances, the term of the lending, maximum amounts of the loans, prohibitions on balloon payments, compounding interest or interest on interest.

Loan applicants would have to state in writing that they have received from

the lender a statement prepared by the consumer credit commissioner regarding the advisability and availability of independent information and counseling services on reverse mortgages. The consumer credit commissioner would be required to develop this information, provide consumer information on reverse mortgages and their alternatives, and refer consumers to independent counseling services.

Advances made as part of a reverse mortgages would have priority over other property liens filed after the reverse mortgage lien was filed.

For determining eligibility for any means-tested state program, such as low-income energy assistance, medical assistance or general assistance, reverse mortgage loan advances would be considered loan proceeds and not income and undisbursed funds from a reverse mortgage would be considered equity in the home and not loan proceeds.

**Equity Loan Recovery Fund.** The consumer credit commissioner would have to establish an equity loan recovery fund for reimbursing persons who suffered actual damages as a result of misrepresentation, dishonesty or fraud committed by a home equity lender. A borrower could recover from the fund only if recovery had been ordered by a court against the lender and the lender was unable to pay. A request for damages that ultimately resulted in payment from the recovery fund would have to be brought within two years after the harm occurred. To finance the fund, the Finance Commission would be required to establish and collect fees from lenders for each home equity loan the lender made.

**Division of Access to Financial Services.** The Division of Access to Financial Services would be created within the Office of Consumer Credit Commissioner to inform, monitor and report on home equity lending. The division would have to conduct research on the effect of equity lending. In addition, it would have to conduct a public information campaign to provide low-income and elderly consumers with information and counseling about the benefits and liabilities of home equity loans, compile a summary of lender information about their home equity lending, and submit to the Legislature a biennial report that included recommendations on actions needed to protect consumers with respect to home equity lending. Lenders would have to submit annual reports detailing their home equity loan

activity to the director of the Division of Access to Financial Services.

After May 1, 2000, the director of the division would have to conduct a study of home equity lending that included: a summary of lenders reports on their home equity lending activities and an analysis of the effectiveness of provisions intended to protect borrowers, and any other relevant information. The report would have to be submitted to the governor, lieutenant governor and speaker of the house by January 1, 2001.

**Miscellaneous.** The bill also would:

- add a definition of equity loan mortgagee policy in the Texas Title Insurance Act; and
- require the insurance commissioner to promulgate an endorsement to be attached to an equity loan mortgagee policy to ensure the priority of future advances.

SUPPORTERS  
SAY:

*(See also analysis of HJR 31)*

CSHB 1188 would be a prudent, reasonable way to allow Texans to tap the equity in their homes. The bill would allow two types of loans — extensions of credit and home equity loans.

**Equity loans.** In addition to the numerous consumer protection provisions in HJR 31, CSHB 1188 would cap the maximum interest rate on equity loans at the maximum rate established by the Legislature, currently between 18 percent and 24 percent, to ensure that borrowers are not overcharged. It would be unnecessary to allow borrowers to bring suits under the Deceptive Trade Practices Act (DTPA) because the protections that consumers would receive under the consumer credit commissioner would be stronger and more effective.

**Extensions of credit, reverse mortgages.** CSHB 1188 would establish guidelines for reverse mortgages, which would be considered extensions of credit, that were separate from those for equity loans. Reverse mortgages are usually structured to give borrowers a monthly payment for several years that is repaid when the borrower leaves the house or the house is sold.

CSHB 1188 would include model language developed to regulate reverse mortgages. For example, reverse mortgages could be made without regard to other laws limiting the use of future advances or the term of advances. Other provisions would ensure borrowers would be treated fairly. Lenders would not be able to reduce the amount or number of payments to a borrower because of an adjustment in interest rates. Lenders who do not make payments to a borrower would be penalized

CSHB 1188 would allow these loans to be due only when a homestead was sold or all borrowers moved out of the house. This would ensure that borrowers could not be kicked out of the house, even if monthly payments had finished.

In addition, borrowers would have to receive information prepared by the consumer credit commissioner about the advisability and availability of information and counseling services concerning reverse mortgages.

CSHB 1188 also would ensure that reverse mortgages loans would not affect eligibility for means-tested government programs such as Medicaid or social security.

**Equity loan recovery fund.** CSHB 1188 would provide additional assistance to consumers by setting up a fund to aid persons who have suffered damages from dishonesty or fraud committed by a home equity lender.

**Division of Access to Financial Services.** The Division of Access to Financial Services, as a part of the Consumer Credit Commissioner's Office, would monitor and report on home equity lending, including studying the effectiveness of provisions intended to help borrowers. Through lender's reports, the division would be able to monitor equity lending in Texas to examine access by all Texans to these loans.

OPPONENTS  
SAY:

*(See also analysis of HJR 31)*

CSHB 1188 should contain additional protections for consumers and lenders. Lenders should be prohibited from making loans that are beyond consumers' ability to repay and borrowers should be able to bring a civil

cause of action against a lender if this happens. This would help prevent situations like the one recently reported in which a man in Virginia was given an initial loan that was refinanced 10 times in less than four years resulting in loan proceeds to the borrower of \$23,000 but a debt of \$45,000 and \$19,000 in loan fees to the lender. Giving consumers the ability to sue an unscrupulous lender under the Deceptive Trade Practices Act would give them a tool to combat fraud and other deceptive practices.

CSHB 1188 should create an independent entity like the Office of Public Insurance Council or Public Utility Council to represent consumers and to take legal actions against systematic abuse by lenders.

**Equity loans.** CSHB 1188 should include a reasonable cap on interest rates on home equity loans that is lower than the 18 percent to 24 percent cap currently on consumer loans. Home equity loans are lower risk than other consumer loans, such as credit cards or car loans, and so the interest rate should be lower. Without a lower cap, homeowners could be charged higher than necessary rates, resulting in unaffordable payments for borrowers and unwarranted profits for lenders.

In addition, borrowers should be given the option to renegotiate their loan before a foreclosure. This could be especially useful if a person fell behind because of a temporary change in their financial situation such as a job loss.

**Extensions of credit, reverse mortgages.** CSHB 1188 would fail to give borrowers who receive extensions of credit the same protections that would be given to home equity borrowers. If these provisions are not to be included in the Constitution, they should at least be in the enabling legislation. Borrowers who take out these loans, which include reverse mortgages or first-lien refinances in which the borrower received some cash, should be given the same protections as equity borrowers, and lenders should be held to the same standards.

Persons taking out reverse mortgages deserve special protections because these are often elderly homeowners who are vulnerable targets for unscrupulous scam artists. In addition, counseling by an independent, licensed counselor should be made mandatory for applicants for reverse mortgages. This would ensure that borrowers fully understand their

responsibilities if they take out a loan. This could help prevent borrowers from being victimized by dishonest businesses such as telemarketing scam artists calling senior citizens and offering to set up a reverse mortgage for a fee.

**Equity loan fund.** CSHB 1188 should be more clear about when a cause of action resulting in a payment from the fund could be taken against a lender for dishonest or fraudulent practices. The bill requires a request for damages to be brought within two years of but should also state that the statute of limitation does not run until discovery of the harm.

NOTES:

The committee substitute made numerous changes to the original version of the bill including adding provisions concerning extensions of credit loans; making changes to the provisions concerning reverse mortgages; changing the maximum loan ratio from 90 percent to 75 percent and eliminating a written notice to be given to borrowers.