

SUBJECT: Amending constitutional provisions on reverse mortgages

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Averitt, Solomons, Denny, Ehrhardt, Elkins, Grusendorf, Marchant
0 nays
2 absent — Pitts, Juan Solis

SENATE VOTE: On final passage, March 18 — 31-0

WITNESSES: For — Robin Gillespie, Fannie Mae; Bill Stinson, Texas Association of Realtors
Against — None

BACKGROUND: In 1997, Texas voters approved a constitutional amendment allowing homeowners to obtain loans and other extensions of credit based on the equity of a residence homestead. Equity is the difference between a home's market value and what is owed on the home.

Home equity loans enable homeowners to convert the equity built up in their homes into spendable cash. Most home equity loans are paid in a lump sum, and loan repayments begin immediately. If a homeowner fails to make a monthly installment, the lender may foreclose, which could result in the homeowner's being forced to sell and vacate the home.

Reverse mortgages, also known as reverse annuity mortgages and home equity conversion mortgages, are another type of equity loan authorized by the Texas Constitution, but they are fundamentally different from other home equity loans. Only homeowners who are or whose spouses are 55 years or older may obtain reverse mortgages under the Constitution. The borrower receives loan advances based on the equity in the borrower's homestead. However, repayments do not begin until the homeowner no longer occupies the property or transfers it to another owner. Once entered into, reverse mortgages have priority over other liens placed on the property.

Advances under a reverse mortgage can be paid in a single lump sum or by equal, periodic installments. Lenders may not decrease the number or dollar amount of advances because of fluctuations in interest rates. The monthly payment amount generally is calculated by a formula developed by the U.S. Department of Housing and Urban Development (HUD) that takes into account the youngest borrower's age, the expected interest rate, the maximum loan amount under Federal Housing Administration (FHA) rules, and the expected length of time the borrower will be receiving payments. Once an installment plan begins, the borrower cannot increase or decrease the amount of the installment payment or ask for the remaining equity to be paid in a lump sum. Reverse mortgage loans, like other home equity loans authorized in Texas, do not establish lines of credit.

The loan balance, consisting of payments made by the lender and any interest, comes due once the homeowner and spouse no longer occupy the property. At that time, the home often is sold and the proceeds are used to pay off the loan. Any money remaining after the reverse mortgage is paid goes to the borrowers or their heirs. If the home is transferred to heirs, the loan balance is due at the time of transfer, regardless of whether the borrower still lives there. If the loan balance exceeds the value of the house, the estate or heirs are responsible only for the value of the home. FHA insures the lender for any additional amounts.

DIGEST:

CSSJR 12 would amend provisions of Art. 16, sec. 50 of the Texas Constitution authorizing reverse mortgage loans. It would increase the minimum age of a borrower or borrower's spouse to 62 from 55 years.

CSSJR 12 would establish three methods by which advances, other than a lump-sum advance, could be paid to the borrower:

- ! equal payments at regular intervals;
- ! unequal payments at regular intervals, if the borrower requests that the amount advanced be reduced for one or more specific payments; or
- ! direct payments at any time of taxes, insurance, repairs, assessments levied against the property, and any lien with priority over the reverse mortgage, if the borrower fails to pay them.

The lender could use any combination of these three payment methods, so long as the loan agreement established the terms of the advances. With

respect to paying for maintenance or repairs, the lender could not pay an employee of the lender or a person or company affiliated with the lender.

The joint resolution would specify that notice from the borrower would be required before the lenders would have to forfeit all principal and interest for failing to make loan advances as required and for failing to remedy their fault.

CSSJR 12 would stipulate that no repayment of principal or interest could begin until:

- ! all borrowers had died;
- ! the homestead property was sold or otherwise transferred;
- ! all borrowers had ceased occupying the property for at least 12 months without prior written consent of the lender; or
- ! the borrower defaulted on obligations required by the loan agreement, committed actual fraud in connection with the loan, or failed to maintain the priority of the reverse mortgage lien.

Defaulted obligations could include failure to repair and maintain the property, to pay taxes and assessments, or to insure the property. If the borrower failed to maintain the priority of the reverse mortgage lien, the lender would have to give the borrower 10 days to restore the priority of the reverse mortgage lien. The joint resolution would allow borrowers to pursue three courses of action:

- ! discharge any other lien that has priority or otherwise agree in writing to discharge the other lien in a manner acceptable to the reverse mortgage lender;
- ! secure an agreement from the other lender subordinating that loan to the reverse mortgage; or
- ! initiate in good faith legal proceedings to prevent enforcement of the other lien.

Failure to pursue any of these three courses of action would constitute grounds for foreclosure. Lenders would have to disclose the provisions for repayment and default by written notice to the borrower at the time the loan was made.

CSSJR 12 would prohibit lenders from commencing foreclosure until the lender notified the borrower by mail of the grounds for foreclosure. The lender would have to give the borrower 30 days to remedy the condition creating the grounds for foreclosure, to pay any debts from proceeds of the sale of the property, or to convey the property to the lender by deed in lieu of foreclosure. Only 20 days' notice would be required if the borrower failed to maintain the priority of the reverse mortgage lien, as the borrower already would have had 10 days to restore the reverse mortgage's priority.

A court order would be required for any foreclosure for a ground other than the death of the borrowers or the sale or transfer of the homestead property. The Texas Supreme Court would have to promulgate rules of civil procedure for expedited foreclosure of a reverse mortgage lien requiring a court order.

The proposed constitutional amendment would be presented to voters at an election on November 2, 1999. The ballot proposal would read: "The constitutional amendment relating to the making of advances under a reverse mortgage and payment of a reverse mortgage."

**SUPPORTERS
SAY:**

CSSJR 12 would give elderly homeowners in Texas the opportunity to supplement their monthly income with equity they have built up in their homestead and would reinforce strong constitutional protections against foreclosure. The provisions of the 1997 constitutional amendment allowing reverse mortgages did not provide sufficient legal certainties to cause a market for reverse mortgages to develop in Texas. This proposed amendment would establish a more complete framework to develop reverse mortgages and would balance successfully the needs of senior citizens and the interests of lenders.

While they have been authorized by the Constitution since 1997, no reverse mortgages have been issued in Texas. Several provisions in the constitution intended to authorize reverse mortgages effectively have prohibited them.

The Constitution stipulates that repayment of the loan cannot begin until all borrowers cease occupying the homestead for more than 180 consecutive days *and* the location of the owner is unknown to the lender. As a result, reverse mortgages have been impossible to obtain in Texas. No lender would make a loan knowing that the borrower could avoid repayment simply by notifying the lender of the borrower's new address.

Also, several provisions conflict with federal rules and the policies of Fannie Mae, the congressionally chartered home-mortgage lending corporation. For example, these rules require homeowners to be 62 years old, not 55 as in the Constitution, to qualify for a reverse mortgage.

In addition to making changes that would allow lenders to make reverse mortgages, CSSJR 12 would add substantial consumer protections to help avoid foreclosure on those who continue to reside in the homestead. It explicitly would define causes of default and ways of rectifying these causes before a foreclosure proceeding could begin. A court order would be required to foreclose for all causes except the death of all borrowers or the sale or other transfer of the property. The amendment would protect elderly Texans from being forced to sell or vacate their homes because of technicalities, unforeseen circumstances, sudden expenses, or oversights. These protections would be similar to those afforded other home equity borrowers in Texas.

The amendment would clarify the conditions that trigger repayment of the loan. It expressly would include the death of all borrowers, which otherwise was only implied, as a condition that would allow lenders to recover principal and interest. It would extend to 12 months, from the current 180 days, the period for which the borrowers could cease occupying the property before triggering repayment, and it would delete the provision allowing repayments to begin once the location of the homeowner was unknown to the lender. Doing so would enable homeowners who travel or summer elsewhere to retain their homes and to continue receiving payments while temporarily away from home.

Lenders could step in when needed to protect their security interests. They would be authorized to pay taxes, insurance, maintenance and repairs, assessments, and any other liens on the property. These payments could be in addition to regular installments. This would be a protection against default, because it would allow these bills to be paid even at times when the homeowner's resources were stretched thin by medical or other unexpected expenses. At the same time, homeowners would be protected from unscrupulous lenders paying affiliated people or companies for repairs and adding these payments to the principal.

The amendment would give borrowers the flexibility to reduce installment payments for particular months if they chose to. Some seniors would obtain

reverse mortgages to help pay for medications and other medical care costs that were not the same amount every month. This flexibility would allow homeowners to reduce the total amount of principal and interest over the life of the mortgage while still allowing them enough of an installment to cover these costs as they occurred. Consistent with other equity loans, the borrower could not increase the installment amount above the figure agreed to in the loan contract and the HUD formula.

CSSJR 12 would harmonize state laws with federal rules and guidelines, thus encouraging reverse mortgage lenders to provide the product to Texas' 2.2 million senior citizens. As the number of elderly Texans increases over the next few decades, reverse mortgage loans would enable more Texans to supplement their retirement and social security incomes.

OPPONENTS
SAY:

Though a step in the right direction, the proposed amendment would create reverse mortgages that were unnecessarily restrictive. Texas ought to allow homeowners to establish lines of credit in addition to or in lieu of lump-sum or periodic payments. Borrowers in other states can do this, and it makes reverse mortgages more attractive to borrowers and lenders alike. Borrowers should have the flexibility to adjust their installments up or down as needed and ought to be able to request a lump-sum payment of the remaining amount at any time. This flexibility is available in other states.

The Texas Constitution should specify that the payments made by the lender should be made out to the borrower only, except in cases when the lender needs to make direct payments to cover taxes, insurance, repairs and maintenance, assessments, or priority liens. This would reduce the likelihood that seniors would be duped into giving their equity away to another person or company.

NOTES:

The committee substitute changed the Senate-adopted proposal by:

- ! adding the stipulation that a court order would be necessary to foreclose a homestead property for a reverse mortgage lien, except in cases where the borrowers had died or the property was sold or otherwise transferred;
- ! requiring lenders to give borrowers 30 days to rectify conditions prompting foreclosure;
- ! providing more detailed remedies for the borrower to restore the priority of the reverse mortgage lien;

- ! requiring lenders to notify borrowers of the specific provisions regarding default and repayment at the time the loan was made;
- ! adding more specific provisions regarding the lender's authority to pay taxes, repair costs, and other obligations of the borrower; and
- ! requiring the Supreme Court to promulgate certain foreclosure rules.