

**SUBJECT:** Authorizing home equity lines of credit

**COMMITTEE:** Financial Institutions — favorable, without amendment

**VOTE:** 5 ayes — Solomons, Christian, Flynn, Gutierrez, Hopson  
1 nay — Wise  
1 absent — Paxton

**SENATE VOTE:** On final passage, May 14 — 26-5 (Barrientos, Gallegos, Ogden, Shapleigh, Staples)

**WITNESSES:** No public hearing

**BACKGROUND:** In 1997, Texas voters approved Proposition 8 (HJR 31 by Patterson), amending Texas Constitution, Art. 16, sec. 50 to allow homeowners to obtain loans and other extensions of credit based on the equity of their residence homestead. Equity is the difference between a home's market value and what is owed on the home. 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. Under Art. 16, sec. 50(f), a home equity loan may be refinanced only with another home equity loan.

Reverse mortgage loans are fundamentally different from other home equity loans. Only homeowners who are or whose spouses are at least 62 years old may obtain reverse mortgages. 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. 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. The Federal Housing Administration insures the lender for any additional amounts.

**DIGEST:**

SJR 42 would propose amending the Constitution to allow lenders to issue home equity lines of credit to homeowners, not to exceed 50 percent of the homestead's fair market value, or 80 percent when added to total indebtedness secured by the home. A borrower could debit the account from time to time, request advances, repay debt, and reborrow money. No single advance could be less than \$4,000, and the borrower could not use a credit card, debit card, check, or similar device to obtain an advance. The amendment would allow repayment in regular, equal periodic installments not more often than every 14 days and not less often than monthly, beginning no later than two months after the credit was issued.

A lender could collect fees on the line of credit only at the time it was established and could not charge or collect fees in connection with a debit or advance, nor amend the extension of credit unilaterally. The written notice that a lender must provide to a borrower 12 days before closing on a home equity loan would be amended to include information describing the borrower's rights regarding home equity lines of credit. A lender would have to provide a translated copy of the notice to a borrower if discussions about a home equity loan were conducted primarily in a language other than English.

SJR 42 would establish provisions under which a lender would forfeit all principal and interest if the lender failed to comply with legal obligations regarding the issuance of a home equity loan, unless the lender cured the noncompliance by:

- refunding overcharged amounts;
- sending written notice of the failure to comply and acknowledgment of the lien's proper scope;
- adjusting borrowers' accounts to ensure that they were not overcharged;
- gathering missing signatures; or
- crediting the borrower \$1,000 and offering the borrower the right to refinance at no cost on the same terms with modifications to correct the noncompliance.

SJR 42 would amend Art. 16, sec. 50(f) to allow the refinancing of a home equity loan with a reverse mortgage loan. It would allow mortgage brokers to make home equity loans and would make home equity loans, like home equity

lines of credit, payable in substantially equal periodic installments not more often than every 14 days and not less often than monthly.

The amendment also would authorize the Legislature to enact laws delegating one or more state agencies the power to interpret certain subsections of Art. 16, sec. 50.

The proposal would be presented to voters at an election on Tuesday, November 4, 2003. The ballot proposal would read: "The constitutional amendment authorizing a home equity line of credit, providing for administrative interpretation of home equity lending law, and otherwise relating to the making, refinancing, repayment, and enforcement of home equity loans."

**SUPPORTERS  
SAY:**

SJR 42, if approved by voters, would increase the availability of home equity lending in Texas, driving down interest costs to consumers. Home equity borrowing should be more flexible and capable of being tailored to individual needs. One way of achieving that objective is through lines of credit.

Currently, Texans may apply only for lump-sum home equity loans, forcing them to borrow the entire amount of a home equity loan even if they do not need all of the money immediately. Allowing home equity lines of credit would give Texas homeowners the right and freedom to use their homes as they saw fit and to obtain smaller loans over time as the money was needed. This could save Texas homeowners thousands of dollars in interest over the life of a loan.

SJR 42 would protect borrowers from casually requesting an advance from their home equity lines of credit by setting the minimum advance at \$4,000. For most Texans, this minimum would be sufficient to signal that they should draw on home equity lines of credit only for truly significant purchases and would discourage them from financing smaller consumption expenditures with their home equity.

Inability to obtain home equity lines of credit is costing Texans substantial sums of money. To use the equity they have built up in their homes, they either must seek lump-sum loans that may be more than they need or must seek high-interest, unsecured loans that do not offer an income-tax break.

Since interest on loans secured by a home is tax-deductible and also is lower than the interest on other loans, home equity lines of credit offer borrowers a double benefit.

Home equity lines of credit in Texas could supplant almost \$13 billion in higher-cost, non-tax-deductible loans such as credit cards and auto loans. That could save Texas consumers an estimated \$741 million annually in interest charges and federal income taxes. These savings also would have a ripple impact on the state's economy by lowering interest rates and freeing capital for other uses, without expanding homeowners' overall debt burden.

The constitutionally enshrined procedural safeguards that already govern home equity loans ensure that borrowers are treated fairly and that they understand their responsibilities. Borrowers receive written notices outlining the home equity law. Equity loans and lines of credit can be made only by licensed financial institutions, not by other lending-type establishments such as pawnshops or check-cashing businesses. Possibly consumers' strongest protections are the 12-day mandatory "cooling off" period after a lender receives a loan application and the three-day window after a loan is made within which the borrower has the right to rescind a loan. Very few, if any, other loans have such substantial protection. At some point, government must trust that consumers are capable of recognizing a bad deal within the 15 days they have to cancel a home equity loan and walk away from it. SJR 42 would alter none of these safeguards.

Texas is more stringent than any other state in terms of home equity consumer protections. Additional regulation would impede the availability and price of home equity lending. One reason why interest rates are higher in Texas than in other states is that the Constitution places so many restrictions on home equity lending. Additional delays, repetitive notices, and state laws that duplicate federal laws slow the process and create unnecessary burdens. Excessive safeguards for consumers ultimately constrain borrowers by reducing the availability of loans and driving up interest rates.

Fears of borrowers losing their homes as a result of defaulting on home equity lines of credit are overblown and unfounded. Home equity loan defaults are rare, perhaps because borrowers go to great lengths to make payments, even in an economic downturn, since the loan is secured by their home. Nationwide

delinquency rates for home equity lines of credit are only half the already low rate of delinquencies on closed-end home equity loans. The borrower can take out a smaller loan with lower interest rates and a lower monthly payment, all of which actually lowers the likelihood of delinquency or foreclosure on home equity lines of credit, as opposed to traditional home equity loans.

SJR 42 would cap the amount of debt that could be borrowed against a homestead to ensure that homeowners retain some ownership in their homes, have some cushion in case the value of the home falls, and have an incentive not to default on the loan. The home equity line of credit and all other debt against a property could not exceed 80 percent of the market value of the property. Also, the line of credit could not exceed 50 percent of the home's market value. This cap would make home equity lines of credit safer for consumers than traditional home equity loans, because disreputable lenders who simply wanted to make money quickly would have a harder time doing so on the lower-dollar loans capped at 50 percent, rather than 80 percent, of a home's market value.

Home equity lenders in Texas often are uncertain about whether a particular action would violate the Constitution and require them to forfeit the principal on a loan. However, since home equity lending in Texas is authorized by the Constitution rather than by statute, no state agency is authorized to give guidance on the Constitution's meaning. That uncertainty translates into higher interest rates for all home equity loans as lenders try to cover the market risk they face. SJR 42 would solve the problem by giving the Finance and Credit Union commissions the responsibility of clarifying home equity law. This would enable lenders to make loans with confidence that their actions were within the law, thus lowering their risk and, consequently, lowering the interest rates charged to consumers.

The constitutional status of home equity lending regulations ensures that both consumers and lenders are protected strongly and prevents the regulations from being altered easily. The homestead has been sacred in Texas history, and any provision that would create the possibility of losing one's homestead should be in the Constitution. Another reason for giving interpretive authority to a state agency, as proposed by SJR 42, is to allow the more minor details to be established outside of the Constitution without making that document more unwieldy than necessary.

SJR 42 also would enable consumers to refinance home equity loans with reverse mortgages, a practice that the Constitution prohibits only as an unintended consequence of previous amendments. Between 1997 and 2001, many of the homeowners who took out home equity loans would have preferred to use reverse mortgages. Now that reverse mortgages are available, some of these homeowners would like to refinance their home equity loans as reverse mortgages.

Adding this refinancing option would benefit senior homeowners in particular. Volatile financial markets have caused the investment income of many retirees to shrink, making it difficult for them to continue monthly payments on home equity loans. Paying off a home equity loan with a reverse mortgage would decrease their monthly financial obligations and would enable them to receive a monthly income from the lender. Reverse mortgages require as many if not more consumer protections than home equity loans, so this policy change would not make consumers more vulnerable. SJR 42 would not require the use of reverse mortgages to finance home equity loans but would give consumers the choice to do so.

Current law places no restrictions on how homeowners may use the proceeds from a reverse mortgage, except that they cannot refinance a home equity loan. They can pay off credit-card debt or other loans, but not home equity loans. No justification exists for this distinction, and SJR 42 would end it, allowing older homeowners more freedom to use what in most cases is their most valuable asset.

**OPPONENTS  
SAY:**

Authorizing home equity lines of credit could lead to Texans taking on additional debt, backed by their homes, to finance routine consumption spending. The need to protect the homestead has not diminished, since many Texans still face personal economic pressure. Besides, other avenues exist for consumers to finance real needs such as college costs and medical expenses.

The current economic downturn has resulted in a higher foreclosure rate, forcing people out of their homes for defaulting on debt unrelated to the homestead itself. With the foreclosure rate increasing, government should be working to protect homeowners' investments rather than making it easier for them to lose their homes. The best stimulant to a strong economy is home ownership and increasing home equity. Establishing the ability to finance

consumer spending with a home equity line of credit might create a short-term burst of economic activity, but a decline would follow when borrowers realized the extent of their debt burden. Texans should be increasing their savings, not inflating their debt burden.

Texas needs to regulate traditional home equity loans more effectively before opening the door to home equity lines of credit. All home equity lending transactions convert an asset into a debt, a practice that should be regulated by any government that desires to protect the fruits of its citizens' hard work.

In some parts of the state, particularly those with the nation's highest rates of subprime lending, consumers are not receiving information in their primary language or in a format they understand. Consequently, they are making uninformed decisions. Hearings around the state have confirmed that borrowers do not understand consistently that their homes can be foreclosed if they default on a home equity loan. Many consumers report being charged in their home equity loans for products that they never received. This is particularly egregious when borrowers lose their homes for defaulting on payments for products they never received. Other commonly reported problems with predatory lending in Texas include:

- Many lenders charge fees, such as discount fees and origination fees, that they do not categorize as fees. Thus, these charges are not subject to the constitutional 3 percent cap on fees above principal, and lenders can violate the spirit of constitutional safeguards.
- The good-faith estimate provided to a borrower 12 days before the loan is closed often is substantially different from the actual loan costs.
- For high-equity homes, lenders often look only at the equity in a home, not at the borrower's repayment ability. This is particularly a problem for the elderly, who tend to be cash-poor but house-rich. Lenders may lend large amounts based on the equity in a home, even though the borrower's fixed income is insufficient for loan repayment.
- Late fees are excessively high.
- Credit insurance is being assessed a finance charge by lenders rather than being treated like automobile or homeowners insurance, which is not subject to a finance charge even when paid in installments.

A basic assumption of healthy market functioning is that both the buyer and seller are fully informed. The fact that borrowers are not informed of a basic feature of home equity loans — that their home is at risk in case of default — indicates a market failure. Home equity loans should not be expanded to include lines of credit without additional consumer protections, such as itemized disclosure of charges, easily comprehensible consumer information, and expansion of fees subject to the 3 percent cap.

Reverse mortgage fees are high in relation to their benefit. To the extent that SJR 42 would increase the issuance of reverse mortgages, more Texans might be getting less for their equity.

**OTHER  
OPPONENTS  
SAY:**

The Constitution should not be amended to increase the details of home equity lending regulation. Such details should be placed in the statutes.

SJR 42 should not include a debt-to-value ratio. Homeowners should be able to tap all of their equity, not only an arbitrary portion.

**NOTES:**

SJR 42 includes the substance of HJR 23 by Hochberg, allowing the refinancing of home-equity loans with reverse mortgages, which the House adopted on April 9 and was reported favorably, without amendment, by the Senate Business and Commerce Committee on May 21.

The enabling legislation for the provision in SJR 42 that would authorize administrative interpretation of home equity law, SB 1067 by Carona, is on today's General State Calendar.