SUBJECT: Revisions to home equity loan constitutional provisions

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 6 ayes — Solomons, Flynn, Anchia, Anderson, McCall, Orr

0 nays

1 absent — Chavez

WITNESSES: For — John Heasley, Texas Bankers Association; Karen Neeley, Independent Bankers Association of Texas; (*Registered, but did not testify:* Mindy Carr, Texas Land Title Association; Jeff Huffman, Texas Credit Union League; Olga Kucerak, Texas Association of Mortgage Brokers; Randy Lee, Stewart Title Guaranty Company; Melodie Stegall, Credit Union Legislative Coalition; Larry Temple, Texas Mortgage Bankers Association)

Against — Robert Doggett, Texas Low Income Housing and Information Service; (*Registered, but did not testify:* Ann Baddour, Texas Appleseed; Don Baylor, Center for Public Policy Priorities; Kristin Carlisle, Texas Low Income Housing Information Service; Randall Chapman, Texas Legal Services Center; Joe Sanchez, AARP-Texas; Kristi Thibaut, Association of Community Organizations for Reform Now; Emily Pratte; Kathleen Tyler; Robert Widrow)

On — Tom Morgan, Texas Association of REALTORS; (*Registered, but did not testify:* Leslie Pettijohn, Consumer Credit Commission)

BACKGROUND: In 1997, Texas voters approved Proposition 8 (HJR 31 by Patterson), which amended Texas Constitution, Art. 16, sec. 50 to allow homeowners to obtain loans and other extensions of credit based on the equity of their residence homesteads.

In 2003, Texas voters approved Proposition 16 (HJR 42 by Carona) making homestead home equity lines of credit (HELOC) available to Texas home owners. A HELOC allows consumers to access a revolving line of credit with a maximum line of credit of 80 percent of the market value of the home minus any loans secured. The borrower may

make withdrawals of at least $4,000 as needed, up to the credit limit. The credit limit remains in place as long as the loan is paid down, and the borrower can continue withdrawing from the account as long as that limit is not exceeded.

DIGEST:

CSHJR 72 would amend provisions in Texas Constitution, Art. 16, sec. 50 regarding home equity loans. CSHJR 72 would specify that a home equity loan could not be secured by a homestead property that was designated for agricultural use on the date of sale. The borrower could not use a preprinted check unsolicited by the borrower to obtain an advance under a home equity line of credit. The 12-day waiting period for closing a home equity loan would commence on the date the loan application was submitted.

The home equity borrower would not be required to sign a loan document unless all substantive blanks on the document had been filled in. The homeowner would be required to receive a copy of the loan application one business day prior to the loan closing. The lender, at the time the home equity loan was made, would have to provide the homeowner with a copy of the final loan application and all executed documents signed by the owner at closing.

The borrower could secure a loan against the equity in his or her home within one year of obtaining the same type of loan on the same homestead only if the borrower on oath requested an earlier closing due to a state of emergency declared by the governor or the U.S. president that applied to the area where the homestead was located.

The notice that the lender must provide the borrower at least 12 days prior to closing a home equity loan would be revised to start when the owner submitted a *loan* application. CSHJR 72 would add to the existing requirement that the loan could not close without the borrower's consent before one business day after the date on which the applicant received a final itemized disclosure of loan fees, points, interest, costs, and charges that the owner also would have to receive a copy of the loan application.

The proposal would be presented to the voters at an election on Tuesday, November 6, 2007. The ballot proposal would read: "The constitutional amendment to clarify certain provisions relating to the making of a home equity loan and use of home equity loan proceeds."

SUPPORTERS SAY:

CSHJR 72 would make several important clarifications to home equity lending practices and add stronger protections for consumers. The proposed amendment also would allow a homeowner to receive a copy of the final loan application and all executed documents signed at closing. This would allow the homeowner to ensure that no misinformation was included in the loan application, and the homeowner would have an exact copy of the loan terms to which he or she agreed. Such disclosure would be critical given that borrowers are held legally responsible for the information they include in a loan application.

In response to the financial ramifications of hurricanes Rita and Katrina, it is evident that homeowners need easier access to the equity in their property in the event of a natural disaster. The proposed amendment would recognize the difficult situation in which homeowners find themselves when their homesteads lie in an area included in a declaration of emergency and would allow these homeowners to obtain a second home equity loan in less than one year.

CSHJR 72 would clarify the intent of the prohibition against the use of preprinted checks to access a home equity line of credit. Homeowners still could use checks to access home equity lines of credit if they used checks that they requested, but homeowners would not receive unwanted solicitations by lenders to use preprinted checks to purchase special offers. Homeowners should not be encouraged to borrow money against their homes unless they determined it was necessary. The proposed amendment would also clarify that a borrower would not be required to sign a document unless all substantive blanks had been filled in. Current law states that all blanks must be filled in and this causes an administrative burden and confusion over whether or not every irrelevant blank would have to be designated as not applicable.

In establishing the designation of the agricultural use lien on the date the property closed, the proposed amendment would prevent homeowners from inappropriately sheltering their homesteads from foreclosure by changing the designation of use for their property.

The Third Court of Appeals in considering a pending lawsuit, *ACORN, et al. v. Finance Commission of Texas, et al.*, and the Finance Commission are reviewing 70 years of legislative intent on usury laws to make a determination on whether or not an origination fee or other fees in a home equity loan would be deemed interest or included in the 3 percent fee cap

on a home equity loan. This proposed amendment appropriately would leave the issue of what constitutes fees included in the 3 percent cap to be addressed after further judicial review.

Many legitimate companies rely solely on oral applications to conduct their business. Also, many consumers prefer to make oral loan applications as a matter of convenience. CSHJR 72 would not exclude oral applications from lending practices; however, it would require that the consumer receive a copy of the loan application prior to closing so that the consumer could confirm the information included in the application.

The proposed amendment would maintain current protections against rolling unsecured debt into a secured home equity loans. A person's home is one of the most stable assets he or she possesses, and the equity in a person's home should not be used lightly. For example, allowing the consumer to pay off other debt with a loan could encourage irresponsible spending on a credit card by a person knew the credit card debt could be paid off with credit from the equity in his or her home.

Finally, CSHJR 72 would not need to clarify that a variance in an itemized disclosure of loan fees, points, interest, costs, and charges could be corrected without delaying the loan closing date. Regulating bodies have interpreted the "good cause" justification for modifying a document on the date of closing to include such variances.

OPPONENTS SAY:

CSHJR 72 should clarify that for the purpose of calculating the fees associated with a home equity loan, origination and certain other fees should be included. The original intent of including the fee cap on a home equity loan was to ensure that a borrower was not charged excessively for the loan. As long as the Constitution remains silent, courts will continue to rule in favor of the lending industry, excluding any fee that might be termed interest from the calculation of the 3 percent cap on fees.

HJR 72 as filed appropriately would have implemented a provision to exclude oral applications from being acceptable forms of home equity loan application. Only written and electronic applications should be acceptable, because these forms of application allow the borrower to confirm the information that was used as the basis of the loan determination at the time the application was submitted. Receiving a loan application a day before closing gives a lender more flexibility to make mistakes, because consumers would be less likely to correct a mistake if it could delay

closing.

The Constitution should not stipulate so strictly the way a borrower can use credit from a home equity loan. Some victims of predatory lending become trapped by high interest rates charged by exotic loan products. HJR 72 as introduced would have allowed a homeowner to use credit to repay another debt to the lender not secured by the homestead.

Finally, CSHJR 72 should clarify that a lender could modify previously provided documentation on the date of closing in the event that a homeowner recognized a variance from expected terms in the final itemized disclosure regarding fees, points, interest, costs, and charges. If a borrower requests changes to incorrect terms in the itemized disclosure, the lender often hesitates to close on the same business day the correction is made. Although most borrowers would consent to correcting such errors and closing right away, it is not explicit that a variance constitutes "good cause" to make such a change on the date of closing.

OTHER OPPONENTS SAY:

HJR 72 as filed appropriately would have excluded interest from the calculation of the 3 percent cap on fees charged on the principal of a home equity loan. Usury law is clear that fees such as an origination fee are included in the definition of interest. Lending law should uniformly apply existing definitions from usury laws that were created to protect consumers from outrageous interest charges.

NOTES:

HJR 72 as introduced explicitly would have stated that interest would not be included in the 3 percent cap on fees and charges made on the loan. The 12-day waiting period for closing a loan would have commenced on the date a written or electronic loan application was submitted. A homeowner would not have been required to receive a copy of the loan application one business day prior to the loan closing. A homeowner could not have been exempted from the one-year waiting period to close a second home equity loan on the same homestead unless the emergency situation materially and adversely affected the health, safety, or financial condition of the owner. HJR 72 as introduced would have required that the borrower receive a copy of all documents and disclosures signed at closing. An owner could have voluntarily applied the proceeds of an extension of credit to repay another debt to the lender that was not secured by the homestead if the owner acknowledged on oath that the payment was voluntary and was beneficial to the owner.

NOTES: According to the Legislative Budget Board, the cost to the state for publishing the resolution would be $77,468.