ISSUES IN HOME EQUITY FINANCING

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CHAPTER 16

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I. INTRODUCTION

When Texas incorporated homestead protection into the Constitution of 1845, it was the first state to do so. In 1988, when Texas legalized Home Equity financing, it was the last state to do so. The one hundred and fifty three year gap between the creation of the Homestead protection and the legalization of Home Equity financing underscores Texas' long-standing commitment to protecting Texans' homes from the reach of creditors.

Since Texas' adoption of Home Equity financing seventeen years ago, the legislature, regulators and courts have responded to a variety of issues but new ones continue to emerge. This paper will discuss some of these issues within the context of Constitutional requirements, regulatory interpretations and the historical evolution of the homestead.

II. EVOLUTION OF THE TEXAS HOMESTEAD

A. Texas Colonization (1821-1836)

After Mexico gained its independence from Spain in 1821, Texas and Coahuila were combined to create the Mexican state of Coahuila y Tejas. To encourage colonization of Texas, Mexico granted *empresarios* the right to bring colonists to Texas. One *empresario*, Stephen F. Austin, understood that many of the immigrants were fleeing creditors from their former states. Austin encouraged the legislature of Coahuila y Tejas to create a legal refuge that would protect the colonists' homes from seizure by foreign creditors.

> "*Many Americans who settled in Texas in the early nineteenth century were pursued by their creditors, and for their protection Stephen F. Austin recommended a moratorium on the collection of the colonists' foreign debts. In response to that recommendation, the legislature of Coahuila and Texas enacted Decree No. 70 of 1829 to exempt from creditors' claims lands received from the sovereign as well as certain movable property.*"[1]

The **Cohuila y Tejas Decree No. 70** provided:

> "*The lands acquired by virtue of colonization law … shall not be subject to the payment of debts contracted previous to the acquisition of said lands, from whatever source the said debts originate or proceed*."[2]

Though Decree No. 70 was repealed in 1831, the principle of protecting the home from seizure by creditors had been expressed and would remain in the minds of Texans when they declared their independence from Mexico in 1836.

B. Republic of Texas (1836-1845)

The Texas Act of 1839 revived the homestead protection created by Coahuila y Tejas Decree No. 70.

> *"Be it enacted by…the Republic of Texas…there shall be reserved to every citizen or head of a family in this Republic, free and independent of the power of the writ…or other execution.. his or her homestead…"*[3]

C. Annexation and Statehood (1845-1861)

As a prerequisite to Texas' annexation by the United States, Texans approved the Constitution of 1845, which reiterated Texas' commitment to protect the homestead from seizure by creditors.

The Constitution of 1845

Article 12, Section 22 provided:

> *"The legislature shall have power to protect by law, from forced sale, a certain portion of the property of all heads of families. The homestead of a family… shall not be subject to forced sale for any debts hereafter contracted…"*[4]

Members of the Texas Constitutional Convention of 1845 chose to permanently inscribe homestead protection constitutionally rather than legislatively because they did not want to subject this fundamental right "*to the whim and caprice of the Legislature*."[5]

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[1] McKnight, Joseph W., *Homestead Law*, http://www.tshaonlinge.org/handbook/online/articles/mhc04 (accessed May 19, 2015).

[2] McKnight, Joseph W. *Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle*, 86 S.W. Historical Quarterly 369 (1983).

[3] Wilkinson, A. E. *The Author of the Texas Homestead Exemption Law.* 20 S.W. Historical Quarterly 35 (1916).

[4] www.tarlton.law.utexas.edu/constitutions/texas1845 (accessed May 12, 2015).

[5] Thomas J. Rusk, Speech, *Debates of the Texas Convention* (Austin, August 5, 1845).

Protection of the homestead has been included in every Texas Constitution since 1845.

D. Confederate States of America (1861-1865)

Constitution of 1861

The Constitution adopted by Texas after its succession from the United States restated the homestead protections set out in the Constitution of 1845.[6]

E. Post-Civil War and Reconstruction (1865-1870)

Constitution of 1866

Texas' first post war Constitution again restated the homestead protections set out in the Constitution of 1845.[7]

Constitution of 1869

Texas' next Constitution included provisions mandated by the U.S. Congress for readmission into the United States but it also restated homestead protections set out in the previous two state constitutions.[8]

In addition to the general protection of the homestead from seizure by creditors, the 1869 Constitution introduced specific debts that could be enforceable against the homestead: purchase money, taxes and improvements.

Article XII, Section XV of the Constitution of 1869 provided:

> *"…The homestead of a family…shall not be subject to forced sale for debts, except for the purchase thereof, for the taxes assessed thereon, or for labor and materials expended thereon…"*[9]

F. Readmission to the United States and Modern-day Texas (1870-present)

Constitution of 1876

After Texas was readmitted into the United States in 1870, Texans sought to repeal and replace the Constitution of 1869, which had been adopted during Texas' period of military occupation and rule.

The resulting Constitution of 1876 remains the underlying organic law of Texas. It is also one of the lengthiest state Constitutions. Since 1876, the legislature has proposed 666 constitutional amendments of which 484 have been approved by Texas voters.

Article 16, Section 50(a) of the 1876 Constitution, which delineates Texas' homestead law, has been amended ten times since 1876.

The list of debts enforceable against the homestead has grown to reflect an evolving Texas but the fundamental protection of the homestead remains intact.[10]

The Constitution of 1876, Article 16, Section 50(a) provides:

> *"The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except the following*":
>
> *(1) Purchase money;*
> *(2) Taxes;*
> *(3) Owelty of partition;*
> *(4) Refinance of lien against the homestead;*
> *(5) Work and materials for new improvements or repair and renovation for existing improvements;*
> *(6) Home Equity financing*
> *(7) Reverse Mortgages*
> *(8) Conversion of personal property lien secured by manufactured home to real estate lien*

III. HOME EQUITY FINANCING UNDER ARTICLE 16, SECTION 50(a)(6)

A. Texas Voters Approve Home Equity Financing

In 1997, the 75th Texas legislature passed HJR 31 to permit Home Equity financing. On November 4th, 1997, 59.6% of Texas voters approved HJR 31 and the following January 1st, 1998, Article 50(a)(6) became part of Texas law.

The comprehensive consumer protections incorporated into Section 50(a)(6) make Texas' Home Equity financing the most consumer-protective in the nation. "*Texas is the only state with a regulation limiting home equity lending…Rules governing home equity borrowing are not uniform across the U.S. and Texas' rules are significantly more stringent.*[11]

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[6] Buenger, Walter L. *Constitution of 1861,* Handbook of Texas Online. http://www.tshaonline.org/handbook/online/articles/mhc04 (accessed May 7, 2015).

[7] McKay, S. S. *Constitution of 1866,* Handbook of Texas Online. http://www.tshaonline.org/handbook/online/articles/mhc06 (accessed May 7, 2015).

[8] McKay, *S. S. Constitution of 1869.* Handbook of Texas Online. http://www.tshaonline.org/handbook/online/articles/mhc06 (accessed May 7, 2015).

[9] www.tarlton.law.utexas.edu/constitutions/texas1869 (accessed May 7, 2015).

[10] "*Amendments to the Texas Constitution Since 1876,* Texas Legislative Council, www.tlc.state.tx.us/pubsconamend/constamend1876.pdf (accessed May 3, 2015).

[11] Kumar, Anil and Skelton, Edward. *Did Home Equity Restrictions Help Keep Texas Mortgages from Going*

Lenders who fail to cure their 50(a)(6) violations within 60 days notice from the borrower face a potentially catastrophic result: termination of the lien and forfeiture of all principal and interest.

B. Regulatory Interpretations Authorized

The initial 50(a)(6) which went into effect in 1998 did not delegate interpretive authority to a state agency though the Office of Consumer Credit Commissioner issued a non-binding set of interpretations. These initial interpretations were helpful but lenders and consumer groups required a more definitive, binding interpretive rulebook.

In 2003, Texas voters approved a new Section 50(u) to the Constitution.

> *"The legislature may by statute appoint one or more state agencies with the power to interpret subsection a(5)-(7)…"* [12]

The legislature amended the Finance Code to authorize the Finance Commission and Credit Union Commission to issue interpretations of 50(a)(6).[13]

IV. SECTION 50(A)(6) HOME EQUITY FINANCING REQUIREMENTS WITH SELECTED REGULATORY COMMENTARY

A. Texas Constitution, Article 16, Section 50(a)(6) provides:

> "*The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except the following…*
>
> *(6) an extension of credit that:*

1. 50(a)(6)(A)
is secured by a "*voluntary lien on the homestead created under a written agreement with the consent of each owner and each owner's spouse;*

Regulatory Commentary:

7 Texas Administrative Code (TAC) Rule 153.2(1)
"*The consent of each owner and each owner's spouse must be obtained, regardless of whether any owner's spouse has a community property interest or other interest in the homestead."*

2. 50(a)(6)(B)
is an amount that when added to aggregate of all debts against homestead does not exceed 80% of the fair market value of the homestead at the time of closing;

3. 15.41350(a)(6)(C)
is without personal recourse except for fraud;

4. 50(a)(6)(D)
is secured by lien that may only be foreclosed by Court order;

5. 50(a)(6)(E)
does not require owner or spouse to pay, in addition to interest, fees that exceed 3% of original principal amount;

Regulatory Commentary:

7 TAC Rule 153.5 (3) (B) "*Legitimate discount points are interest and are not subject to the three percent limitation. Discount points are legitimate if the discount points truly correspond to a reduced interest rate…"*

7 TAC Rule 153.1 (11) *"Interest- As used in Section50(a)(6)(E), "interest" means the amount determined by multiplying the loan principal by the interest rate over a period of time."*

6. 50(a)(6)(F)
if the loan is an open end account, it must be a Home Equity Line of Credit;

7. 50(a)(6)(G)
is payable in advance without penalty or charge;

8. 50(a)(6)(H)
is not secured by any additional real or personal property other only than the homestead;

9. 50(a)(6)(I)
is not secured by property with Agricultural property tax designation (unless property used primarily for milk production);

10. 50(a)(6)(J)
may not be accelerated because of decrease in market value or default in other debt not secured by prior lien on homestead;

11. 50(a)(6)(K)
is the only Home Equity loan on the property;

Regulatory Commentary

Underwater? Southwest Economy, Federal Reserve Bank of Dallas (3Q 2013).
[12] Tex. Const. art. XVI, §50(u).
[13] Tex. Fin. Code §11.308 and §15.413.

7 TAC Rule 153.10(1) *"Number of Equity loans. An owner may have only one equity loan at any time, regardless of the aggregate total outstanding debt against the homestead."*

12. 50(a)(6)(L)(i)
is scheduled to be repaid: in "*substantially equal successive periodic payments*" not more often than every two weeks and not less often than monthly, beginning no later than two months from closing, "*each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment";*

Regulatory Commentary

7 TAC Rule 153.11 (3) "*For a closed-end equity loan to have substantially equal successive periodic installments, some amount of principal must be reduced with each installment. This requirement prohibits balloon payments."*

7 TAC Rule 153.11 (4) *"Section 50(a)(6)(L)(i) does not preclude a lender's recovery of payments as necessary for other amounts such as taxes, adverse liens, insurance premiums, collection costs, and similar items."*

7 TAC Rule 153.1 (1) *"Balloon- an installment that is more than an amount equal to twice the average of all installments scheduled before that installment."*

13. 50(a)(6)(L)(ii)
if it is a Home Equity line of credit, the periodic payments also must be regular periodic installments payable not more often than every 14 days and not less often than monthly, beginning not later than 2 months from closing;

14. 50(a)(6)(M)(i)
is not closed before 12th day after owner submits loan application and lender provides Home Equity Notice;

15. 50(a)(6)(M)(ii)
is not closed for at least one business day after owner receives copy of loan application (if not previously received) and a final itemized closing statement;

Regulatory Commentary:

7 TAC Rule 153.13(3) *"A lender may satisfy the disclosure requirement of providing a final itemized disclosure of the actual fees, points, interest, costs, and charges …by delivering to the borrower a properly completed …HUD-1 or HUD-1A."*

16. 50(a)(6)(M)(ii)
if owner has "*bona fide emergency or other good cause"* and of "*lender obtains written consent owner*", lender may provide copy of loan application and final itemized closing statement on the date of closing;

17. 50(a)(6)(M)(iii)
is not closed before at least one year since last Home Equity loan on the same property;

Regulatory Commentary

7 TAC Rule 153.14(2) "*Section 50(a) (6) (M) (iii) does not prohibit modification of an equity loan before one year has elapsed since the loan's closing date. A modification of a Home Equity loan occurs when one or more terms of an existing equity loan is modified, but the note is not satisfied and replaced. …"*

7 TAC Rule 153.14(2) (A) *"A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law…"*

7 TAC Rule 153.14(2) (B) "*The advance of additional funds to a borrower is not permitted by modification of the equity loan."*

7 TAC Rule 153.14(2) (C) *"The modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit."*

7 TAC Rule 153.14(2) (D) *"The 3% cap required by Section 50(a) (6) (E) applies to the original Home Equity loan and any subsequent modification as a single transaction."*

18. 50(a)(6)(M)(iii)
may be closed within one year of previous Home Equity loan on the property if state of emergency has been declared by the President or Governor for the area where the homestead is located;

19. 50(a)(6)(N)
is closed only at the office of the lender, an attorney or a title company;

Regulatory Commentary:

7 TAC Rule 153.15(1) *"An equity loan may be closed at the permanent physical address of the office of branch office of the lender, attorney at law, or title company. The closing office must be a permanent physical address so that the closing occurs at an authorized physical location other than the homestead."*

7 TAC Rule 153.15(2) *"Any power of attorney allowing an attorney-in-fact to execute closing documents of behalf of the owner or the owner's spouse must be signed by the owner or the owner's spouse at an office of the lender, an attorney at law, or a title company. A lender may rely on an established system of verifiable procedures to evidence compliance with this paragraph…"*

20. 50(a)(6)(O)
permits a fixed or variable rate of interest;

Regulatory Commentary:

7 TAC Rule 153.16(2) *"An equity loan must amortize and contribute to amortization of principal."*

21. 50(a)(6)(P):
is made only by a qualified Home Equity Lender:

- bank, savings and loan or credit union doing business under Texas or federal law;
- federally chartered lender or person federally approved to make federally insured loans;
- a person licensed in Texas to make regulated loans;
- a person who sold the homestead to the owner and provided financing for the purchase;
- a person related to the owner within the second degree of affinity or consanguinity;
- a person regulated by Texas as a mortgage broker;

22. 50(a)(6)(Q)(i)-
owner is not required to use loan proceeds to pay non-Homestead debt to Home Equity lender;

23. 50(a)(6)(Q)(ii)
owner has not assigned wages as security;

24. 50(a)(6)(Q)(iii)
owner has not signed document with blanks of "substantive terms";

25. 50(a)(6)(Q)(iv)
owner has not signed confession of judgment or power of attorney to lender or third party to confess judgment or appear for owner in judicial proceeding;

26. 50(a)(6)(Q)(v)
at closing, owner receives copy of final loan application and all executed documents;

27. 50(a)(6)(Q)(vi)
Deed of Trust discloses that it is a Home Equity loan;

28. 50(a)(6)(Q)(vii)
within "*reasonable time"* after loan is paid off, lender must cancel and return Note and provide recordable release of lien to owner or copy of assignment of the lien to lender who is refinancing the Home Equity loan;

29. 50(a)(6)(Q)(viii)
owner and "*any spouse of the owner"* may rescind loan within 3 days after closing *without penalty or charge;*

30. 50(a)(6)(Q)(ix)
owner and lender sign a written acknowledgement of fair market value of the homestead property on the closing date;

50(a)(6)(h)
A lender …may conclusively rely on the written acknowledgement as to the fair market value….if:

1. *the value acknowledged …is an appraisal or evaluation prepared in accordance with a state or federal requirements…"*
2. *the lender…does not have actual knowledge…that the fair market value stated in the written acknowledgement is incorrect."*

31. 50(a)(6)(Q)(x)
lender and any holder of the Note "*shall forfeit all principal and interest*" of the Home Equity loan "*if the lender or holder fails …to correct the failure to comply not later than the 60th day after the date the lender or holder is notified by the borrower of the lender's failure to comply by:"*

Regulatory Commentary

7 TAC Rule 153.91 (a) "*A borrower notifies a lender or holder of its alleged failure to comply with an obligation by taking reasonable steps to notify the lender or holder of the alleged failure to comply. The notification must include:*

(1) Identification of the borrower;
(2) Identification of the loan; and
(3) Description of the alleged failure to comply.
(b) A borrower is not required to cite in the notification the section of the Constitution that the lender or holder allegedly violated."

7 TAC Rule 153.94
"(a) (T)he day after the lender or holder receives the borrower's notification is day one of the 60-day period. …

(b) If the borrower provides the lender or holder inadequate notice, the 60-day period does not begin to run."

7 TAC Rule 153.93

"*(a) at closing, the lender or holder may make a reasonable conspicuous designation in writing of the location where the borrower may deliver a written or oral notice of a violation…*

(d) If the lender or holder does not designate a location where the borrower may deliver a notice of violation, the borrower may deliver the notice to any physical address or mailing address of the lender or holder.

7 TAC Rule 153.94

"(a) the lender or holder may correct a failure to comply… on or before the 60th day …if the lender or holder delivers required documents, notices, acknowledgements, or pays funds by:

(1) placing in the mail, placing with other delivery carrier, or delivering in person the required documents, notices, acknowledgements, or funds;

(2) crediting the amount to the borrower's account;

(3) using any other delivery method that the borrower agrees to in writing…"

7 TAC Rule 153.95

"(a) If the lender or holder timely corrects the violation…then the violation does not invalidate the lien."

(b) A lender or holder who complies…to cure a violation before receiving notice…receives the same protection as if the lender had timely cured after receiving notice.

(c) A borrower's refusal to cooperate fully with an offer that complies …to modify or refinance an equity loan does not invalidate the lender's protection for correcting a failure to comply."

32. 50(a)(6)(Q)(x)(a)
lender pays owner any overcharge;

33. 50(a)(6)(Q)(x)(b)
lender sends owner written notice that lien is valid only in the amount that the loan does not exceed 80% limit or is secured by ineligible property;

34. 50(a)(6)(Q)(x)(c)
lender sends owner written notice modifying any prohibited provision and adjusts borrower's account to be compliant

35. 50(a)(6)(Q)(x)(d)
lender delivers required documents to borrower or obtains required signatures;

36. 50(a)(6)(Q)(x)(e)
if there is another Home Equity loan already on the property, lender sends owner written notice that interest and other obligations are "*abated"* until the other Home Equity lien is released;

37. 50(a)(6)(Q)(x)(f)
if violations cannot be cured under the previous provisions, lender sends/credits owner with $1000 and offers to refinance loan with the same rate and at no cost to owner in order to comply with the law;

Regulatory Commentary

7 TAC Rule 153.96

"(b) To correct a failure to comply…:(1) the lender or holder has the option to either refund or credit $1000 ; and (A) modify the equity loan without completing the requirements of refinance; or (B) refinance the extension of credit that complies with 50(a)(6).

(d) After a borrower accepts an offer to modify or refinance, the lender must make a good faith attempt to modify or refinance within a reasonable time not to exceed 90 days."

38. 50(a)(6)(Q)(xi)
the lender and any holder "*shall forfeit all principal and interest"* if the lender is not an authorized Home Equity lender or if the lien was created without the consent of all owners and all owners spouses (unless all owners and spouses subsequently consent)

V. SOME UNRESOLVED HOME EQUITY FINANCING ISSUES

A. Are Home Equity Claims Subject to a Four-Year Statute of Limitations?

1. Background

Although 50(a)(6) contains many details for a compliant 50(a)(6) loan, it is silent on a limitations period for filing claims/lawsuits based on violations.

Texas law provides a residual four-year Statute of Limitations for laws that do not contain a limitations period.

> "*Every action for which there is no express limitations period, except an action for the recovery of real property, must be brought not later than four years after the day the cause of action accrues."*[14]

A majority of Texas courts have applied this residual four-year statute of limitations to 50(a)(6) cases filed more than four years after loan closing. A few courts have refused to apply the four-year statute of limitations.

The Texas Supreme Court has not addressed this issue, but a petition for review is currently before the Court.[15]

This issue first emerged in 2008 when the Dallas Court of Appeals in the case of *Rivera v. Countrywide Home Loans, Inc* applied the four-year statute of limitations to bar the plaintiff's 50(a)(6) claims.[16]

In 2001, the Riveras obtained a Home Equity loan from Countrywide Home Loans. As part of their loan documentation, the Riveras and Countrywide signed an acknowledgement of fair market value that the home was worth $350,000.

The appraisal obtained by Countrywide indicated that the property was worth between $261,040 and $293,580, not $350,000. Rivera was given a copy of the appraisal at closing.

Five years after closing, the Riveras fell behind in their payments and Countrywide initiated foreclosure proceedings.

The Riveras filed suit in state court, claiming Countrywide violated the requirements of 50(a)(6)(B) by lending more than 80% of the home's value at the time of closing. Countrywide filed for summary judgment, claiming the Riveras' claim was barred by the residual four-year statute of limitations. The trial court granted Countrywide's summary judgment.

The Riveras appealed. On appeal, the Riveras conceded that the four-year statute of limitations applied to their claim.

> "*The Riveras and Countrywide agree the four-year statute of limitations applies to the constitutional …causes of action.*"[17]

Rather than argue the applicability of the statute of limitations to a 50(a)(6) claim, the Riveras claimed the accrual date of their claim was "*the date of the final installment."*[18]

The Court of Appeals found that the Riveras' cause of action accrued on the date of closing. Because the Riveras did not argue the applicability of the four-year statute of limitations, the court did not address whether the four-year statute should even apply to the lawsuit.

After *Rivera*, other Texas courts applied the four-year statute of limitations to violations of Article 50(a)(6). In *Schanzle v. JPMC Specialty Mortgage, LLC*, the Austin Court of Appeals applied the four-year statute of limitations after a *pro se* appellant failed to properly brief the issue.[19] Federal courts followed the lead set by Texas courts and applied the four-year statute of limitations to 50(a)(6) claims.[20]

In 2011, a Federal District court in *Smith v. JPMorgan Chase Bank* refused to follow *Rivera* and decided that the residual four-year statute of limitations did not apply to 50(a)(6) violations.[21]

The *Smith* Court noted that the Texas Supreme Court had not addressed the issue whether the residual four-year statute of limitations applied to 50(a)(6) violations.

> "*As this Court's jurisdiction is based on diversity of citizenship, the task … is to determine and apply Texas law*". [22]

The *Smith* Court emphasized specific language of contained in Article 16, Section 50(c) of Texas Constitution:

> "*No mortgage, trust deed, or other lien on the homestead shall ever by valid unless it secures a debt described by this section*…"[23]

[14] Tex. Civ. Prac. Rem. Code §16.051.

[15] *Wood v. HSBC Bank USA, N.A.,* No. 14-13-00389-CV (Tex. App.—Houston [14th Dist.] 2014, pet. filed.).

[16] *Rivera v. Countrywide Home Loans, Inc*., 262 S.W.3d 834, 839 (Tex. App.—Dallas 2008, no pet.).

[17] *Id.* at 839 ("*The Riveras and Countrywide agree the four-year statute of limitations applies to the constitutional …causes of action.").*

[18] *Id.*

[19] *Schanzle v. JPMC Specialty Mortg. LLC,* 2011 WL 832170 (Tex. App.—Austin 2011, no pet.).

[20] *In re Ortegon,* 398 B.R. 431, 440 (Bankr. W.D. Tex. 2008); *In re Chambers,* 419 B.R. 652, 680 (Bankr. E.D. Tex. 2009); *Johnson v. Deutsche Bank Nat. Trust Co,* 2010 WL 4962897, *3 (S.D. Tex. 2010); *Hannaway v. Deutsche Bank Nat. Trust Co.,,* 2011 WL 891669 (W.D. Tex. 2011); *Reagan v. U.S. Bank Nat'l Ass'n,* Civil Action No. H-10-2478, 2011 WL 4729845 (S.D. Tex. Oct. 6, 2011); *Wiliams v. Deutsche Bank Nat. Trust Co.,* 2011 WL 891645 (W.D. Tex. 2011).

[21] *Smith v. JPMorgan Chase Bank, N.A.,* 825 F. Supp.2d 859 (S.D. Tex. 2011).

[22] *Id.* at 861.

[23] *Id.* at 867.

The Court noted that "*a noncompliant mortgage lien against a homestead is thus void ab initio*."[24]

The court found that a noncompliant Home Equity loan was "*void*" (not "*voidable*") but that the loan could be made legal and enforceable if the lender cured the violation within 60 days after receiving notice of such violation.

The *Smith* court distinguished prior cases and examined the language of Texas' residual four-year state statute of limitations. The Court noted that the residual four-year statute of limitations was inapplicable to an action for the *recovery of real property*, which presumably included the borrower's action to terminate the Home Equity lien.

As a final repudiation of the application of the residual four-year statute of limitations to 50(a)(6) violations, the court noted,

> "*Following Rivera would be to grant amnesty to errant lenders as a result of the passage of time, alone. The Court believes that justice for both parties is amply preserved by allowing the debtor to make his claim and allowing the lender to then invoke the cure provisions…"*[25]

A year later, in the case of *Santos v. CitiMortgage, Inc.*, the Federal District Court for the Northern District of Texas addressed the same issue: *does Texas' residual four-year statute of limitations apply to 50(a)(6) violations?*[26]

The court in *Santos* was persuaded by the reasoning in *Smith* and found that the four-year statute of limitations was inapplicable to 50(a)(6) violations. The court distinguished between a borrower's claim that the lien is void and a suit for forfeiture of the equity loan's principal and interest.

According to *Santos*, the borrower's claim to terminate the Home Equity lien was not subject to a four-year statute of limitations period but the suit for forfeiture of all principal and interest was subject to a four-year statute of limitations.

2. The Priester Case

In 2013, the Fifth Circuit rejected the lower courts' analysis of *Smith* and *Santos* with its decision in *Priester v. JP Morgan Chase Bank, N.A.*[27]

In November, 2005, the Priesters obtained a $180,000 Home Equity loan from Long Beach Mortgage. Allegedly, they closed the loan in their own home, rather than the home of the lender, an attorney or title company as required under 50(a)(6)((N). They also claimed that they did not receive a copy of the Home Equity Notice as required under 50(a)(6)(M).

Five years after closing, the Priesters sent a "cure" demand letter to the holder of the Home Equity loan, JP Morgan Chase Bank. Chase took no action to cure the alleged violations.

Several months later, the Priesters filed suit in state court for declaratory relief that the loan was "void ab initio." Chase removed the case to federal court and moved to dismiss the suit, which was granted by the District Court. The Priesters appealed this dismissal.

On appeal, Fifth Circuit adopted the analysis of the state court cases of *Rivera* and *Schanzle* and found that 50(a)(6) claims were subject to Texas' residual four-year statute of limitations.

The court also distinguished between the "discovery rule" and "injury rule" for accrual of an action and was persuaded by the *Rivera* decision that a 50(a)(6) cause of action accrued from the date of loan closing.

> "*The injury occurred when the Priesters created the lien, and there was nothing that made the injury undiscoverable. The Priesters knew that the closing documents were signed in their living room and that they were not given notice of their rights. A lack of knowledge that that was a violation of the law is insufficient to toll limitations."*[28]

Under the *Priester* standard, Plaintiffs' prospects for 50(a)(6) lawsuits filed more than four years after closing are bleak. When such a suit is filed in state court, the out-of-state lender will remove the case to Federal court under diversity jurisdiction, then file for dismissal under Rule 12(b)(5), citing the 5th Circuit standard established in *Priester* .

Under the "rule of orderliness", all 5th Circuit courts are bound by the *Priester* decision, including the 5th Circuit itself.

In *Moran v. Ocwen Loan Servicing, LLC*, the Morans executed a Home Equity loan in 2002, defaulted ten years later and the lender commenced foreclosure. Moran then sent notice to the lender of alleged 50(a)(6) violations. The bank did not cure the alleged violations and Moran filed suit.[29]

The case was removed to federal court, the court granted the bank's motion to dismiss for failure to state a claim and the plaintiffs appealed to the 5th Circuit.

Citing *Priester*, the court upheld the lower court's dismissal and "*because Priester is controlling, we also*

[24] *Id.* at 861.
[25] *Id.* at 868.
[26] 2012 WL 1065464 (N.D. Tex. 2012).
[27] *Priester v. JP Morgan Chase Bank, N.A.*, 708 F. 3d 667 (5th Cir. 2013).
[28] *Id.* at 675.
[29] *Moran v. Ocwen Loan Servicing, L.L.C.*, no. 13-20242, unpublished (5th Cir. 2014).

deny the Morans' motion to certify". Although the Texas Constitution allows certified questions to the Texas Supreme Court, "*certification is not a proper avenue to change our binding precedent."*[30]

The conundrum for plaintiffs who file suit more than four years after loan closing is obvious: because of deference to the *Priester* precedent, if a 50(a)(6) case is removed to federal court, there is little chance that the court will permit certification of questions to the Texas Supreme Court regarding applicability of the four-year statute of limitations.

Fortunately, there is currently pending before the Texas Supreme Court a state court appeal that may provide a clear guidance whether the four-year statute of limitations applies to 50(a)(6) claims.

In *Wood v. HSBC*, Houston's 14th Court of Appeals affirmed the trial court's summary judgment for defendants based on the four-year statute of limitations. The case was appealed to the Texas Supreme Court and the Court may accept the appeal and address the issue.

The Texas Supreme Court has requested briefs on the merits from the parties, which are due by July 3, 2015. If the Supreme Court accepts the case, there should at last be clarity regarding the applicability of the four-year statute of limitations to 50(a)(6) claims.

3. Arguments Against the Application of Four-year Statute of Limitations to 50(a)

a. Liens that Violate 50(a)(6) Requirements are Void.

Article 50(u) of the Texas Constitution provides:

> "*No mortgage, trust deed, or other lien on the homestead shall ever be valid unless it secures a debt described by this section."*[31]

The Constitutional language is clear; "*no mortgage, trust deed or other lien on the homestead shall ever be valid"* unless is it complies with Section 50(a).

Liens that do not comply with of the requirements of 50(a)(6) are void *ab initio*. Under well settled Texas law, void liens, as opposed to voidable liens, are a cloud on title and are not subject to the four year statute of limitations.[32]

b. Imposition of a Four-Year Statute of Limitations Would Undermine Texas' Longstanding Commitment to Protect the Homestead.

Homestead protections in Texas are time-tested and vigorous. Texas was the first state to protect the homestead and last state to allow Home Equity financing.

When Home Equity lending was eventually authorized in 1997, it was purposefully filled with consumer protections. These safeguards had the single goal of protecting Texas homeowners. Limiting borrowers' rights to challenge Home Equity violations through the four-year statute of limitations would frustrate the purpose and spirit of Texas' homestead protections.

c. Language of the Residual Four-Year Statute of Limitations Excludes Actions for the Recovery of Real Property

The residual four-year statute of limitations provides:

> "*Every action for which there is no express limitations period, except an action for the recovery of real property, must be brought not later than four years after the day the cause of action accrue."* [33]

The courts in both *Santos* and *Smith* focused on the words "*except an action for the recovery of real property.*" The test of whether an action is one to recover real estate is if the title asserted by the plaintiff will support an action in trespass to try title. In Texas, where a deed is absolutely void, a trespass to try title suit may be maintained to recover land, irrespective of the residual four year statute of limitations.[34]

4. Arguments For Application of the Four-year Statute of Limitations

a. The Constitutional Cure Provisions Make Non-Compliant Home Equity Liens *Voidable* rather than *Void*

Section 50(a)(6)(Q)(x) of the Texas Constitution provides a notice and cure period for non-compliant Home Equity loans.[35] The section allows borrowers to notify lenders of violations and gives lenders 60 days to "*cure*" the violations. Proponents argue that inclusion of this cure period makes non-compliant equity loans *voidable* rather than *void.*

A lender who is notified of a violation and does not cure within 60 days has a void lien. Until the expiration of the cure period, the lien is only *voidable*.

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[30] *Id.*
[31] Tex. Const. art. XVI, § 50(c).
[32] *See Tex. Land & Loan Co. v. Blalock*, 76 Tex. 85 (1890).
[33] Tex. Civ. Prac. Rem. Code § 16.051.
[34] *See Slaughter v. Qualls*, 162 S.W.2d 671, 674 (Tex. 1942).
[35] Tex. Const. art. XVI, §50(a)(6)(Q)(x).

The four year statute of limitations applies to voidable liens. Borrowers may not sleep on their rights; they must notify the lender of violations within 4 years or the voidable lien becomes valid.

b. Application of the Four-Year Statute of Limitations is Fair

Statutes of limitations provide legal closure to an otherwise open-ended threat of litigation. With the passage of time, evidence becomes stale, witnesses die, change careers or forget the details and documents are lost or destroyed.

Because of the catastrophic penalty for a lender's failure to cure 50(a)(6) violations, there should be a reasonable time limitation on the right of Home Equity borrowers to file suit.

B. Are Incurable 50(a)(6) Violations Subject to the Four-Year Statute of Limitations?

Section 50(a)(6)(Q)(xi) provides:

> "*the lender … shall forfeit all principal and interest …if the extension of credit is made by a person other than a person described under Paragraph (P) of this subdivision or if the lien was not created under a written agreement with the consent of each owner and each owner's spouse, unless each owner and each owner's spouse who did not initially consent subsequently consents."*

If the lender was not an authorized Home Equity lender, then the violation cannot be cured. The previous discussion regarding the four-year statute of limitations involved violations that could have been cured if the borrower had timely notified the lender of those violations. With an unauthorized lender, the situation is different; under the terms 50(a)6)(Q)(xi), that violation could not be cured.

If not all owners and owners' spouses consent to the Home Equity lien, that violation also cannot be cured unless the missing parties subsequently consent.

1. Unauthorized Home Equity Lender

The issue of an unauthorized Home Equity lender was discussed in 2011 in *Boutari v. JP Morgan Chase Bank, N.A.*[36]

In *Boutari*, plaintiffs obtained a Home Equity loan in 1998 from Long Beach Mortgage. Long Beach Mortgage was not an "authorized lender" under Texas law.

Long Beach Mortgage obtained a license to originate Home Equity loans in Texas in October 1999, a year after the Home Equity loans were made to the plaintiffs in this case. The plaintiffs brought suit in 2009, 10 years after closing the original Home Equity loan.

In trial, plaintiffs argued that Long Beach Mortgage (who was later acquired by JP Morgan Chase) was not an authorized lender at the time the Home Equity loan was made, that this was an incurable violation and therefore not subject to the four year statute of limitations.

The plaintiffs relied on the 2003 amendment to support their assertion that an unauthorized lender was an incurable violation. The defendants responded that the claim was time-barred.

The District Court held that the claim was barred by the four-year statute of limitations. The loan was made before the constitutional cure provisions were adopted and those provisions did not have retroactive effect.

The Court reasoned that the plaintiffs' reliance on the 2003 amendment was an implicit admission that prior to 2003, any violation was curable. The Court further noted that even if the four-year statute of limitations did not apply, the defendants cured their violation when they became licensed in October, 1999.

The plaintiffs appealed the award of summary judgment and the Fifth Circuit affirmed the decision in a short, unpublished opinion.

2. Not all Owners and Owners' Spouses Consent to the Home Equity lien

The four-year statute of limitations was also applied in a case where the wife of the Home Equity borrower did not consent to the lien.

Williams v. Wachovia Mortgage Corp. involved a common law marriage. Robert Williams and Deborah Williams moved into a home in 1995.[37] In 2002, Mr. Williams took out a Home Equity loan from World Savings without the wife's knowledge or consent. The husband represented in his Home Equity loan application that he was an "*unmarried man."*

After the Home Equity loan proceeds were spent, the husband informed the wife of the loan. In 2004, the wife filed divorce proceedings against the husband. The husband denied the marriage but a jury found that they were married as common law husband and wife in 1992. The divorce was granted and the home in question was awarded to the wife.

In 2008, the wife brought suit against the holder of the Home Equity loan, Wachovia Mortgage, to remove cloud on title and to quiet title – she wanted the lien removed from her home.

[36] 429 Fed. Appx. 407 (5th Cir. 2011).

[37] 407 S.W.3d 391 (Tex. App.—Dallas 2013, pet. denied).

Wachovia filed for summary judgment, claiming the issue of her non-consent was barred by the four-year statute of limitations. The trial court agreed and granted the motion.

The wife appealed to the Dallas Court of Appeals, who upheld the trial court's judgment. The wife ultimately appealed to the Texas Supreme Court but they denied the petition for review.

Section 50(a)(6)(Q)(xi), which provides for forfeiture of all principal and interest if not all owners and owners' spouses consent to the Home Equity lien, was added to 50(a) by a 2003 constitutional amendment. This provision was not in effect in 2002 when Mr. Williams' Home Equity loan was created. It is unclear whether the result in *William*s would have been different if he had obtained the Home Equity loan after 2003.

C. Does the Executed Acknowledgement of Fair Market Value Provide the Lender a Safe Harbor?

The Dallas Court of Appeals case, *Wells Fargo Bank v. Lonzie Leath*, is a sober reminder to lenders of the severe penalty for failing to cure a 50(a)(6) violation: forfeiture of all principal and interest and termination of the lender's lien.[38]

Lonzie Leath took out a $340,000.00 Home Equity loan in 2005 with H&R Block Mortgage, which was exactly 80% of the $425,000 appraised market value.

At closing, Leath signed an acknowledgement of that the fair market value of the home was $425,000, an amount based on an independent appraisal ordered by the lender. Leath used a substantial part of the Home Equity loan proceeds to pay off an existing mortgage on the property.

In 2008, Leath requested that the lender (now Wells Fargo) modify or restructure the loan to help him get "back on track financially." Wells Fargo refused and began foreclosure proceedings.

In response to Wells Fargo's application for foreclosure, Leath answered that the loan violated 50(a)(6)(B) because the loan exceeded 80% of the fair market value of the property at closing. He also alleged that he had notified Wells Fargo of this more than 60 days previously but that Wells Fargo had done nothing to correct this violation.

At trial, the appraiser who had prepared the $425,000 appraisal testified that the appraisal contained a written condition that certain repairs (estimated to cost several thousand dollars) were needed in order for the property to appraise at the full $425,000. Those repairs were not done before the loan closing.

The case was submitted to a jury on a single question: what was the market value of the property at the time of the loan closing?

The jury found that the market value of the home at the time of loan closing was $421,400 (presumably the $425,000 appraised value less the necessary and uncompleted repairs). The court took judicial notice that Leath's Home Equity loan of $340,000 exceeded 80% of $421,400.

The court then found that the loan violated the 80% limit set out in 50(a)(6)(B) and that Wells Fargo had not cured the violation within 60 days of notification. The court declared that the Home Equity lien was void and the principal and interest of the loan were forfeited. As a final blow, the Court awarded attorney's fees to Leath's attorney.

Wells Fargo argued on appeal to the Dallas Court of Appeals that Leath failed to give proper of notice to Wells Fargo of the violations, as required by 50(a)(6)(Q)(x).

The Court of Appeals found that Leath's answer to the foreclosure application was sufficient notice to satisfy the Home Equity requirements. Because "*the issue of notice was conclusively established by the evidence of the record…it was unnecessary to submit the question (to the jury) of whether Leath notified Wells Fargo of its alleged non-compliance…*"[39]

A mutually executed acknowledgment of fair market value should provide a safe harbor for a Home Equity lender but in this case, it appears the lender was aware, or should have been aware, that the $425,000 appraised value was dependent on completion of certain repairs before closing, which repairs were not done.

> *"A lender or assignee for value may conclusively rely on the written acknowledgment as to the fair market value of the homestead made in accordance with this Subsection…if:*
>
> *(1) The value acknowledged to is the value estimate in an appraisal or evaluation prepared in accordance with a state or federal requirement…; and*
> *(2) the lender…does not have actual knowledge…that the fair market value…is incorrect."*

The record indicates a substantial portion of the Home Equity proceeds were used to pay off an existing, valid mortgage on the homestead. Wells Fargo should have been subrogated, and their lien

[38] 425 S.W.3d 525 (Tex. App.—Dallas 2014, pet. denied).

[39] *Id.* at 533.

should have been valid, for at least the amount spent to pay off the prior lien.[40]

Wells Fargo appealed to the Texas Supreme Court, which denied the petition.

D. Will the New Federal Loan Disclosures Impact Texas Home Equity Loans?

Texas Home Equity loans are subject to the new home loan disclosure requirements mandated by Dodd-Frank and implemented by the Consumer Financial Protection Bureau that take effect October 1, 2015.[41]

The Consumer Financial Protection Bureau (CFPB), the new federal consumer protection agency created under Dodd-Frank in 2010, has issued a number of mortgage-related regulations that have had a powerful impact on the entire mortgage industry.

Beginning with loan applications received on or after August 1, 2015, new borrower disclosure documents will be required for all mortgage loans, including Texas Home Equity loans.

All home loan lenders (including Home Equity lenders) will be required to provide a new disclosure at loan application called the "Loan Estimate", which combines the current Good Faith Estimate of Closing Costs and the Early Truth in Lending Disclosure.

Three days prior to loan closing, the borrower must receive a new disclosure called the "Closing Disclosure", which combines the current HUD-1 Settlement Statement and the final Truth in Lending Disclosure.

The new forms are intended to provide borrowers with more and easier to understand loan information.

Both the Loan Estimate and Closing Disclosure contain a "loan purpose" box, which informs the borrower of their type of loan: purchase, refinance, construction, or home equity.

If any of the Home Equity loan proceeds are used to pay off an existing mortgage on the property, the Texas Home Equity loan must be classified as a "refinance."

The Home Equity loan will be classified as a "Home Equity" on the Loan Estimate and Closing Disclosure only if none of the proceeds are used to pay off an existing mortgage.

E. Is a Military Power of Attorney Subject to the Standards Established by the Texas Supreme Court in the Norwood Decision?

The Texas Supreme Court in *Finance Commission of Texas v. Norwood* made clear that a power of attorney used to execute Home Equity loan documents must have been executed in the office of a lender, title company or attorney.[42]

After the *Norwood* decision, the Finance Commission modified Texas Administrative Code §153.15(2) to reflect the Supreme Court's decision. A lender may rely on an established system of verifiable procedures to evidence compliance with the power of attorney requirement.

The requirements for military powers of attorney are set out in 10 U.S. Code §1044b. That section provides in section (a) that a military power of attorney is "*exempt from any requirement of form, substance, formality, or recording that is provided for powers of attorney under the laws of a State; and shall be given the same legal effect as a power of attorney prepared and executed in accordance with the laws of the State concerned.*"

Is the Texas Supreme Court's ruling regarding execution of the power of attorney considered a "form, substance, formality…under the laws of a State…"?

The Texas Supreme Court in *Norwood* discussed the military power of attorney and implied that when Military powers of attorney are used for Home Equity loans, they also must be executed in accordance with the Court's rule.

> "*For the military, the Judge Advocate General Corps provides lawyers here and abroad. We recognize that JAG lawyers may not be as accessible to military personnel as civilian lawyers are…but we also recognize that soldiers and sailors in harm's way are no less susceptible to being pressured to borrow money and jeopardizing their homes than people in more secure circumstance."*[43]

There appears to be a conflict between the language of the federal statute and the requirements set out in the Norwood ruling and that conflict will need to be resolved.

F. How Can a Lender Correct a Home Equity Closing that Used an Improperly Executed Power of Attorney?

This violation appears curable under 50(a)(6)(Q)(x)(f) by refunding/crediting the borrower $1,000 and offering to re-execute the loan with the properly executed power of attorney.

G. May a Lender Modify a Home Equity Loan to Include Amounts Advanced on Behalf of a Borrower for Past-Due Taxes and Insurance?

[40] *Id.* at 540.
[41] 12 C.F.R. 1026 (2011).
[42] 418 S.W.3d 566 (Tex. 2014).
[43] *Id.* at 597.

The Texas Supreme Court recently answered "yes" to this question in *Sims v. Carrington Mortgage Services, L.L.C.*[44].

In 2003, Sims obtained a 30-year Home Equity loan. In 2009, they fell behind on their payments and entered a "Loan Modification Agreement" with Carrington Mortgage Services, LLC. The modification agreement capitalized the past-due interest, unpaid taxes and insurance premiums. The interest rate and monthly payments were reduced.

Two years later, the Sims again fell behind and the lender commenced foreclosure proceedings. The Sims resisted, claiming the 2009 modification violated constitutional requirements for Home Equity loans.

The parties entered a second modification agreement, further reducing the interest rate and payments. Both the 2009 and 2011 modifications provided that all other obligations set out in the original loan documents remained in full force and effect.

The original loan documents required that Sims pay taxes, assessments and insurance premiums and also authorized the lender to "*do and pay for whatever is reasonable or appropriate"* to protect its interest in the property. Any amounts dispersed by lender to that end "*shall become additional debt of Borrower secured by this Security Instrument."*

Shortly after the second modification in 2011, Sims filed suit against the lender in Federal District Court. The borrowers alleged that the modifications violated the requirements of a Texas Home Equity loan. The District Court granted summary judgment to the lender and the Sims borrowers appealed to the Fifth Circuit.

After oral argument, the Fifth Circuit certified four questions to the Texas Supreme Court:

1. *After an initial extension of credit, if a Home Equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance premiums into the principal of the loan but neither satisfies nor replaces the original note, is the transaction a new extension of credit for purposes of Section 50 of Article XVI of the Texas Constitution?*

If the transaction is a modification rather than a refinance, the following questions also arise:

2. *Does the capitalization of past-due interest, fees, property taxes, or insurance premiums constitute an impermissible "advance of additional funds" under Section 154.12(2)(B) of the Texas Administrative Code?*
3. *Must such a modification comply with the requirements of Section 50(a)(6), including subsection (B), which mandates that a Home Equity loan have a maximum loan to value ratio of 80%?*
4. *Do repeated modifications like those in this case convert a Home Equity loan into an open-end account that must comply with Section 50(t)?*

Sims argued that any increase in the principal amount of a Texas Home Equity loan constituted "a new extension of credit" and all the required disclosures and other requirements were imposed on the lender. They also argued that the lender violated the constitution when it increased the loan balance by capitalizing past due amounts, sending the loan to value ratio above 80%.

The Texas Supreme Court held "*the restructuring of a Home Equity loan that… involves capitalization of past-due amounts owed under the terms of the initial loan and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit that must meet the requirements of Section 50.*"[45]

The Court held that advancing past-due interest, taxes, insurance premiums and other fees was not an "*advance of additional funds*" if the borrower was required to pay these amounts in the original loan agreement. "*The test should be whether the secured obligations are those incurred under the terms of the original loan."*[46]

Such advances merely deferred the borrowers' existing obligation under the loan agreement in a way that allowed the borrower to retain their home.

H. May a Lender Modify a Home Equity Loan to Include Amounts Advanced on Behalf of a Borrower When Such Amounts Are Not Past-Due?

To date, there are no court decisions that directly address whether a Home Equity modification can include amounts for taxes, insurance and other items that are not yet past due.

The Texas Supreme Court's ruling in *Sims* discussed only capitalization of past-due sums that were the borrower's obligation under the loan documents. It is not clear if a modification could include not-yet-due amounts that are the responsibility of the borrower.

[44] 440 S.W.3d 10 (Tex. 2014).

[45] *Id.* at 17.

[46] *Id.* at 13.

The typical Home Equity Deed of Trust requires the borrower to pay taxes and maintain insurance. The lender is authorized to pay those amounts if the borrower fails to do so. Payment of those items by the lender before they are past due may be considered an advance of "additional funds" that would necessitate a new Home Equity loan with all of its attendant disclosures.

Under the interpretive rules issued by the Finance Commission/Credit Union Department, "*an advance of additional funds to a borrower is not permitted by modification of an equity loan."*[47]

I. Can a Home Equity Modification Provide for a Balloon Payment or for Interest-Only Payments?

The *Sims* decision did not address whether Home Equity modifications may include interest-only payments and require balloon payments.

Under Section 50(a)(6)(L), Home Equity loans must be "*scheduled to be repaid in substantially equal successive periodic installments*" and each installment "*equals or exceeds the amount of accrued interest as of the date of the scheduled installment."*

The Texas Finance Commission/Credit Union Department has interpreted this repayment requirement to mean that "*some amount of principal must be reduced with each installment*" and that "*this requirement prohibits balloon payments."*[48]

The same Rule states that the requirement for "*substantially equal successive periodic installments" "does not preclude a lender's recovery of payments as necessary for other amounts such as taxes, adverse liens, insurance premiums, collection costs, and similar items."*[49]

Does the phrase "*recovery of payments as necessary*" mean that if the lender advances amounts for past due taxes, they may require such advances to be repaid in manner that would not have been permitted in original Home Equity loan?

The Interpretive rules provide:

> "*A modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit."*[50]

This interpretive rule prohibits repayment terms in the modification agreement that would not have been allowed at the initial closing.

Under 50(a)(6), a Home Equity loan has be repaid in "*substantially equal successive periodic installments*", which had been interpreted to mean that the loan must be amortized and may not require a balloon payment. Further, "*some portion of principal must be reduced with each installment,"* which precludes interest-only payments.

If that rule applies to amounts advanced by the lender to pay past-due taxes, insurance, etc, then the modification agreement should also provide that such advances be repaid in "*substantially equal successive periodic installments.*"

J. Can a Home Equity Borrower Be Personally Liable for the Lender's Attorney's Fees?

In the recent case of *Wells Fargo v. Murphy*, the Texas Supreme Court held that Home Equity borrowers may be personally liable in separate legal actions filed by the borrower after the lender has commenced foreclosure proceedings.[51]

Section 50(a)(6)(C) provides that a Home Equity loan is *"without recourse for personal liability against each owner and the spouse of each owner, unless the owner or spouse obtained the extension of credit by actual fraud*." The only security for a Home Equity loan is the home. If the lender forecloses its lien and there is a deficiency, the lender is prohibited from pursuing the debtor for such deficiency.

In *Murphy*, the borrower received a Home Equity loan from Wells Fargo. Shortly after the loan was made, the borrower fell behind in payments and Wells Fargo initiated foreclosure proceedings.

The borrower filed a separate and original declaratory judgment proceeding against Wells Fargo. Under Texas Rules of Civil Procedure Rule 736.11(a), the separate filing by the debtor automatically stayed the Wells Fargo's foreclosure application and the state district court dismissed the application.

In the debtor's separate declaratory judgment action, Wells Fargo sought summary judgment and attorney's fees, which the trial court granted. Wells Fargo's attorney's fees totaled $116,505.75. The borrowers appealed.

The appellate court upheld the summary judgment but reversed the award of attorney's fees – claiming the award of attorney's fees violated Texas' prohibition on personal liability for Home Equity loans. Wells Fargo appealed to the Texas Supreme Court and the Court granted petition.

The Texas Supreme Court recognized the limitation of personal liability for Home Equity loans but noted that the limitation of personal liability relates only to charges incurred as part of the home equity loan. The attorney fees incurred by the lender in

[47] Tex. Admin. Code, tit. VII, §153.14(B).
[48] *Id.* at 153.11 (3).
[49] *Id.* at 153.11(4).
[50] *Id.* at 153.14(D).
[51] 2015 WL 500636 (Tex. 2015).

defending against the borrower's separate declaratory judgment action were not incurred enforcing the Home Equity note.

> *"Having initiated a separate and original proceeding, and having provided a mechanism for Wells Fargo to both incur and recover its attorney's fees, there is no basis for the Murphys to hide behind the nonrecourse status of their home-equity loan."*[52]

[52] *Id.*