

**HOMESTEAD 2000:
IT AIN'T WHAT IT USED TO BE**

**Dallas Bar Association
REAL PROPERTY SECTION**

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PRESENTED BY:
G. ROLAND LOVE
DONOHOE, JAMESON & CARROLL, P.C.
3400 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270
Phone: (214) 747-5700
Fax: (214) 744-0231

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I. INTRODUCTION

- ♂② Home Equity lending brought the 1998-99 Texas Legislature back to the table again in order to address the oft encountered obstacle of specifically identifying one acre for Home Equity Loans. The urban homestead was expanded to ten acres. New provisions permitting more liberal foreclosure of reverse equity loans were also implemented, making these loans more feasible for lenders. The previous limitations has resulted in essentially no reverse home equity lending in Texas, and the effect of these new provisions remains to be seen.
- ♂② The Legislature also tinkered with the age-old problems of business homestead, overburdening, spreading and the definition of urban and rural. It also took steps to recognize manufactured housing as real property, with purchase money loans, once affixed to the ground.
- ♂② Perhaps the most interesting is an attempt to understand what the Legislature felt needed a Constitutional Amendment and what did not. While the courts were relatively quiet in 1999 in the area of homestead, they will certainly have their opportunities in the future to address these new changes.
- ♂② The title insurance industry has not yet had the opportunity to respond to the changes regarding reverse equity loans, although coverages are available which may do the job. Increased coverage is available in connection with the more traditional home equity loans.
- ♂② Finally, both the Department of Insurance and the State Legislature acted to assure that subsequent assessments for ad valorem taxes based upon removals of exemptions are covered items under the title insurance policy. At the same time, one Dallas County District Judge has preliminarily indicated his opinion that subsequent assessments against bona fide purchasers is illegal.

II. DEFINITIONAL CHANGES

A. TEN ACRES - URBAN

- ♣② S.J.R. No. 22 was passed by the voters November 2, 1999, and amended Section 51, Article XVI of the Texas Constitution, effective January 1, 2000. Current law will control liens and writs of execution prior to that time.
- ♣② In connection therewith, Senate Bill 496 amended Texas Property Code Section 41.002(a) to expand the urban homestead from one acre to ten acres.
- ♣② Section 51, Article XVI, Texas Constitution, is amended to read as follows:

Sec. 51. The homestead, not in a town or city, shall consist of not more than 200 acres of land, which may be in one or more parcels, with the improvements thereon; the homestead in a city, town or village, shall consist of lot or contiguous lots amounting to not more than ten acres [1 acre] of land, together with any improvements on the land;

- ♣② SECTION 1. Subsection (a), Section 41.002, Property Code, is amended to read as follows:

(a) if used for the purposes of an urban or as both an urban home and a place to exercise a calling or business [in the same urban area], the homestead of a family or a single, adult person, not otherwise entitled to a homestead, shall consist of not more than 10 acres [1 acre] of land which may be in one or more contiguous lots, together with any improvements thereon.

- ♣② Section 41.008, Texas Property Code, was also added, effective January 1, 2000, to express the legislature's desire to avoid federal preemption by amendments to the Bankruptcy Code:

Section 41.008. CONFLICT WITH FEDERAL LAW. To the extent of any conflict between this subchapter and any federal law that imposes an upper limit on the amount, including the monetary amount or acreage amount of homestead property a person may exempt from seizure, this subchapter prevails to the extent allowed under federal law.

II. DEFINITIONAL CHANGES

B. BUSINESS HOMESTEAD - CONTIGUOUS AND PART OF THE RESIDENTIAL HOMESTEAD

- ♂② With the insertion of a single word "contiguous" the Legislature also materially changed business homesteads. An urban business homestead is now defined to consist of a lot or contiguous lots amounting to not more than ten acres of land, together with any improvements on their land, provided that the homestead in a city, town or village shall be used for the purposes of a home, or both as an urban home and a place to exercise a [the] calling or business, of the homestead claimant.
- ♂② Prior legal interpretation of the business homestead extended homestead up to one acre within the same metropolitan area.
- ♂② Business homestead now must be part of the same parcel of land used as the residential homestead. No separate business homestead is permitted.
- ♂② Dual use of the property with home and business continues unchanged.
- ♂② Arguably, a sole proprietorship owning property separate from the residential homestead may now borrow against that property for working capital purposes.
- ♂② SECTION 1. Section 51, Article XVI, Texas Constitution, is amended to read as follows:

...the homestead in a city, town or village, shall consist of lot or contiguous lots amounting to not more than 10 acres [one acre] of land, together with any improvements on the land; provided, that the homestead in a city, town or village [same] shall be used for the purposes of a home, or as both an urban home and a place to exercise a [the] calling or business, of the homestead claimant, whether a single adult person, or the head of a family;
- ♂② SECTION 1. Subsection (a), Section 41.002, Property Code, is amended to read as follows:

(a) If used for the purposes of an urban home or as both an urban home and a place to exercise a calling or business [in the same urban area], the homestead of a family or a single, adult person, not otherwise entitled to a homestead, shall consist of not more than 10 acres [one acre] of land which may be in one or more contiguous lots, together with any improvements thereon.
- ♂② One may argue the amendment of [the] to a eliminates the requirement that the urban business homestead be used to exercise the principal occupation of the debtor.
- ♂② A rural homestead, which by definition does not include a business homestead (being urban in nature), may still be comprised of non-contiguous parcels.

II. DEFINITIONAL CHANGES

C. DEFINE URBAN - NOT RURAL

σ② Senate Bill 496 also amended Texas Property Code Section 41.002(c) to define the urban homestead. Prior definitions focused on rural homestead but in an effort to clarify the definitional task, and possibly recognizing the shift in population demographics, the Legislature adopted the following:

A homestead is considered to be urban [rural] if, at the time the designation is made, the property is:

- (1) located within the limits of a municipality or its extraterritorial jurisdiction or a platted subdivision; and
- (2) served by police protection, paid or volunteer fire protection, and at least three of the following services provided by a municipality or under contact to a municipality:
 - (a) electric
 - (b) natural gas
 - (c) sewer
 - (d) storm sewer; or
 - (e) water [not served by municipal utilities and fire and police protection].

σ② The determination of urban and rural character of homestead property will probably continue to be a fact question, and the Property Code will only serve as guidance in making the determination. See United States of America v. Blakeman, 997 F.2d 1084 (5th Cir. 1992) (suggesting a constitutional amendment would be required for a definitive test). It is entirely possible that property within city limits could be rural in character. It is also less likely, but possible, that property outside city limits may be urban, although the Texas Constitution, Article XVI, Section 51 clearly states "in a city, town or village". See Crowell v. Theodore Bender Accounting, Inc., 138 F.3d 103 (5th Cir. 1998) (42 acres were urban; Keller, Texas, was a full service urban city, albeit a small one) and In re Grisham, 230 B.R. 529 (Bkrptcy, N.D. Tex. 1998) (80 acre tract included 11.74 acres in city boundaries - cannot have both rural and urban - factual inquiry determined homestead urban).

- ♂② The courts also continued with fact intensive homestead issues, resulting in a limited expansion of what constitutes homestead. In In re Brooks, 233 B.R. 698 (Bkrptcy, N.D. Tex. 1999) an oral lease and life estate remainder were sufficient to support a homestead. A business homestead even existed where real property was leased to a wholly owned family corporation. Mckee v. Smith, 965 S.W. 2d 52 (Tex. App. - Fort Worth 1998, writ denied.).
- ♂② Finally, once a homestead always a homestead? Not so, but a surviving spouse could keep 200 acres as rural homestead (with the right to pick which 200 she wanted). Riley v. Riley, 972 S.W. 2d 149 (Tex. App. - Texarkana 1998, no writ). And, the burden of proving abandonment is on the party seeking to assert it. Scott v. Estate of Scott, 973 S.W. 2d 694 (Tex. App. - El Paso 1998, no writ.)

III. CHANGES TO PERMITTED LIENS

A. TYPES OF PERMITTED LIENS - UNCHANGED

(Better Ingredients, Better Pizza?)

♂② There is no change to the types of permitted liens by reason of the 1999-2000 Constitutional Amendment. Section 50, Article 16 of the Texas Constitution and Section 41.001 Texas Property Code continue to permit the following seven types of liens against Texas homesteads:

2. Purchase Money
3. Ad Valorem Taxes on the property
4. Cost of improvements on property, if contracted for in writing before the work has started
5. Owelty of Partition Lien, including division of property in divorce
6. Refinance of Federal Tax Lien
7. Home Equity Loan
8. Reverse Mortgage Loan

III. CHANGES TO PERMITTED LIENS

B. PURCHASE MONEY LIENS - MANUFACTURED HOUSING UNITS

- σ② The Texas Legislature undertook to expand the definition of Purchase Money Liens to include existing personal property liens for the purchases of manufactured housing. Pursuant to HB 1086 Texas Property Code 62.002 and 62.003, upon proper affixation of the manufactured housing unit to the real property, a vendors lien, retail installment lien or other lien in the nature of a purchase money lien securing a loan or credit advance, the lien will be treated as a real property purchase money loan.
- σ② Sec. 62.002. APPLICABILITY This chapter applies only to a lien on a manufactured home if the loan or credit advance documents state or indicate that the lien:
- (1) is or is in the nature of a vendor's lien;
 - (2) is or is in the nature of a purchase money lien; or
 - (3) is or is in the nature of a retail installment lien.
- σ② Sec. 62.003. CONVERSION OF LIEN FROM PERSONAL PROPERTY LIEN TO REAL PROPERTY LIEN. When the manufactured home converts to real property as provided by Section 2.001(b), the lien on the property:
- (1) is converted to a purchase money lien on real property by operation of law; and
 - (2) exists independently of any existing lien on the real property to which the home is permanently attached.
- σ② You should continue using a mechanic's lien contract for a new MHU to be placed on the borrower's land. It may also be prudent to inspect the installation before closing a permanent loan. A Certificate of Attachment is required and should be recorded.

III. CHANGES TO PERMITTED LIENS

C. AD VALOREM TAXES

σ② HB 3549 (effective September 1, 1999) amended Tax Code §32.01(c) to provide that when part of an owner's real property description includes the residence homestead and is taxed separately from the remainder of the property, any ad valorem tax liens on the homestead and remainder will extend in solido to the entire property unless the homestead is a separately identified or described parcel in the conveyance or other recorded instrument.

σ② A constitutional question arises as to imposing a lien for taxes on non-homestead property onto homestead property.

III. CHANGES TO PERMITTED LIENS

D. IMPROVEMENTS

1. Repairs or Renovations

- σ② Effective January 1, 1998, the Texas Constitution Section 50(a)(5) was amended to include four requirements in connection with improvements to homestead. These are as follows:
- (A.) The contract must be in writing, with the consent of both spouses; (old law)
 - (B.) The contract must not be executed before the 12th day after the owner makes written application for any extension of credit, except where immediate repairs to conditions on the homestead property that materially affect the health or safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing;
 - (C.) The contract must expressly provide that the owner may rescind the contract without penalty or charge within three days after the execution by all parties, unless the work and materials are necessary to complete immediate repairs to affect the health and safety of the owner or person residing in the homestead and the owner of the homestead acknowledges such in writing;
 - (D.) The contract must be executed by the owner and owner's spouse only at the office of a third-party lender making an extension of credit for the work and material, an attorney-at-law, or a title company.
- σ② By the end of 1999, the Title Industry has consistently concluded that these four sub-parts apply only to "repair or renovate existing improvements" and not to new improvements. In Jim Walter Homes, Inc. v. Spradlin, No. DV98-2895, 134th Judicial District, Judge Packer agreed. This case is now on appeal.
- σ② Thus, when doing any transaction involving a mechanic's lien for repairs or renovations to homestead, one should be certain of the following:
- (1) That the contract provides for three-day right of rescission as set out in (C) above;
 - (2) That the 12-day time period has passed for the owners' application to the lender as set out in (B) above, before the contract is executed;
 - (3) That after signing up the parties, you wait the period of three days for rescission before recording. As no method for giving notice of rescission is stated, you should have confirmation in your file that no rescission is being made before filing; and

(4) You must be certain the closing took place where required as stated in (D) above.

σ② Several cases have also involved constitutional challenges to the constitutional amendment. These plaintiffs have argued:

σ② There was lack of notice to the voters that the Home Equity amendment also affected home improvements;

σ② The amendment is unconstitutionally vague, including **no** definition as to what is a "title company";

σ② The place of signature requirement violates rights of travel, assembly, equal protection and due process; and

σ② The waiting period and rescission period are preempted by federal law.

σ② See Nat'l Ass'n of Remodeling Industry, Inc. - Houston Chapter v. Pettijohn, No. 97-13577, 345th Judicial District, Travis County (dismissed November 1998 with permission to NARI to intervene in Private National Mortgage; Rooms With a View, Inc. v. Private National Mortgage, No. 98-09772, 345th Judicial District, Travis County (Summary Judgment for defendant, April 1999, on appeal); Rooms With a View, Inc. v. Homeowners Mortgage & Equity, No. 98-03286, 201st Judicial District, Travis County (stayed by defendant's bankruptcy filing).

III. CHANGES TO PERMITTED LIENS

D. IMPROVEMENTS

2. Broker's and Appraiser's Lien

Broker's and Appraiser's Lien on Commercial Real Estate Act Chapter 62, Texas Property Code - Commercial Real Estate Only

- ♂② HB 1052 was passed by the legislature to create a lien on commercial real estate for licensed real estate brokers and real estate appraisers for earned commissions based on written contracts, effective September 1, 1999.
- ♂② Commercial real estate is defined in the act as all real estate **except:**
- (A.) Improved with one to four residential units;
 - (B.) Single-family residential unit including condos if sold in single units;
 - (C.) A person's homestead, or a part of a homestead;**
 - (D.) Unimproved property zoned for single family residential use or restricted for single-family use in restrictions that will last more than 2 years;
 - (E.) Primarily used for farming and ranching purposes; will continue to be used primarily for farming and ranching purposes; and is located more than 3 miles from the corporate boundaries of any municipality. Sec. 62003(2)
- ♂② The commission must be based upon a written agreement for commercial real estate. It must be signed by the party having the interest sought to be charged - seller, purchaser, or landlord. Sec.62.021
- ♂② The commission agreement must give notice that a lien can be filed by the broker. Sec.62.021(d). It must be executed after the effective date of the act. HB1052 Sec.2.
- ♂② A notice of commission must be filed with the County Clerk of the County of the property that contains a legal description of the interest sought to be charged with the lien. Sec. 62.025(5).
- ♂② The commission must be earned at the time of filing of the lien affidavit. Sec.62.004(b) Earned is the earlier of (1) as defined in the agreement as eamed or (2) the person obligated to pay the commission enters a contract during the time of the agreement for all or part of the commercial real estate if the purchase contract or lease is contemplated by the commission agreement and if the parties to the purchase contract or lease are contemplated by the commission agreement.
- ♂② The lien on the interest only applies if filed and indexed before the filing of the documents transferring title. Sec. 62.028(b)
- ♂② Over \$2,500 commission must be due under the terms of contract normally, but

- ♂② Over \$5,000 commission must be due if the property:
- (a) Is the principal place of business of the record title owner;
 - (b) Is occupied by more than one and fewer than five tenants; and
 - (c) Is improved with 7,500 sq. ft. or less of total gross building area. Sec. 62.002(b).
- ♂② If the broker claiming a commission files the notice they must give written notice within one business day of the filing to the party who owes the commission. Sec. 62.026(b).
- ♂② If the broker filing a claim notice knows of an escrow agent named in the contract or lease they must send or fax a file-stamped copy of the notice claiming lien to that escrow agent. Sec. 62.026(d).
- ♂② If the escrow agent receives the file-stamped copy of the notice of lien from the broker, the agent may not close the sale or lease unless: The lien is released; the purchaser or tenant closes subject to the lien; the funds are held in escrow as provided by this act; or, a bond is filed as provided by this act. Sec. 62.026(e).
- ♂② Broker means a person who is licensed as a real estate broker under The Real Estate License Act (Art. 6573a, Vernon's Texas Civil Statutes) or a person who is licensed as a real estate appraiser under the Texas Appraiser Licensing and Certification Act (Art. 6573a.2, Vernon's Texas Civil Statutes). Sec. 62.003(1).
- ♂② A lien is not available to an employee or independent contractor of the broker. Sec. 62.021(d).

III. CHANGES TO PERMITTED LIENS

D. IMPROVEMENTS

3. Mechanic's, Contractor's and Materialmen's Liens Changes Effective 9/1/99

- σ② HB2054 was passed making several amendments to Chapter 53 of the Property Code.
- σ② A new subsection was added to Section 53.001 (15) to define "Completion" as follows:
 - (15) "Completion" of an original contract means the actual completion of the work, including any extras or change orders reasonably required or contemplated under the original contract, other than warranty work or replacement or repair of the work performed under the contract.
- σ② Section 53.055 (a) was amended to allow a person filing an affidavit 5 business days after filing to send notice by certified or registered mail to the owner, expanding from 1 day.
- σ② Section 53.158. Period for Bringing Suit to Foreclose Lien. The time for filing suit was changed to be 2 years after the "last day a claimant may file" instead of from when they actually filed the affidavit with the County Clerk. On residential property the period was changed to 1 year after the "last day a claimant may file". This expands the time for filing suit in most cases. Most underwriters have adjusted the time for barring lien claims by affidavit to add 4 months to the date the notice was filed to be certain that it is clearly beyond the new time periods.
- σ② Section 53.256 was amended to allow the owners to waive the requirement they be given a list of all subcontractors and suppliers. The waiver must be in writing and be included in the residential construction contract, or in a separate waiver statement.
- σ② Section 53.260 amended the title to delete the word "Prohibited" and instead use "Not Required" so that it now reads: "CONVEYANCE TO CONTRACTOR NOT REQUIRED". The section was not reworded but it should make it easier to insure a transaction where the owner requests the builder to take title to the lot during construction, for instance, because the builder can obtain an interim loan and the homeowner does not have credit for an interim loan.

III. CHANGES TO PERMITTED LIENS

E. HOME EQUITY LOANS

- ♣② While the legislature and voters addressed difficult practical issues by changing definitions, no substantive changes were made to the wording of Article XVI, Section 50(a)(6). However, home equity loans were not free from court challenges on mainly two bases:
- ♣② the 3% cap on fees was exceeded; and
 - ♣② the payment of loan proceeds to other lenders.
- ♣② The 3% cap was primarily a definitional issue. Borrowers focused on appraisal fees, tax service fees, processing fees, flood search fee, attorney fees, administrative fees, application fees, courier fees, closing fees, document preparation fees, restriction fees, credit report fees, title insurance, endorsements, but most importantly on whether loan discount fees, loan origination fee, or points were really "necessary" to buy down interest rates. See Doody v. Ameriquest Mortgage Co., No. DV98-5033, 95th Judicial District, Dallas County, removed to, No. 3-98CV1844-X, N.D. Tex.; Tarver v. Sebring Capital Credit Corp., No. 98-09-15, 645 CV, 82nd Judicial District, Robertson County; and Maisel v. The Associates Home Equity Services, Inc., No. 98-12856, 126th Judicial District, Travis County.
- ♣② Query: Are yield spread premiums or payoff fees included in payoff amounts included in the 3% fee cap?
- ♣② The payment of loan proceeds question arises due to a difference in language in Section 50(a)(6)(Q)(i) and the notice provision at Section 50(g)(Q)(l).
- ♣② The substantive provision, 50(a)(6)(Q)(i) prohibits home equity loans made on the condition that the loan proceeds are applied to another debt except debt secured by the homestead or debt to another lender.
 - ♣② The notice provision, 50(g)(Q)(l), restates this as another debt that is not secured by your home or to another debt to the same lender.
- ♣② In spite of the borrower's argument that the notice provision prohibited payment of proceeds to an unsecured creditor, at least two courts have held it is clear that the lender may require repayment of any debt secured by the homestead or any debt to another lender, whether or not secured. See McMahan v. Long Beach Mortgage Co., No. 98-082, 216th Judicial District, removed to C.A. No. SA-98-CA-0491-OG (W.D. Tex); Stringer v. Cendant Mortgage Corp., No. 99-40100 (E.D. Tex.) (on appeal). See also Doody, supra, (pending).

III. CHANGES TO PERMITTED LIENS

F. REVERSE MORTGAGES

1. New Conditions of Repayment

- σ② Three new conditions triggering a repayment of principle and interest were added to (k)(6) as follows:
- (A) all borrowers have died;
 - (B) (same);
 - (C) all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval from the lender; or
 - (D) the borrower:
 - (i) defaults on an obligation specified in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property;
 - (ii) commits actual fraud in connection with the loan; or
 - (iii) fails to maintain the priority of the lender's lien on the homestead property, after the lender gives notice to the borrower, by promptly discharging any lien that has priority or may obtain priority over the lender's lien within 10 days after the date the borrower receives the notice, unless the borrower:
 - (b) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to the lender;
 - (c) contests in good faith the lien by, or defends against enforcement of the lien in, legal proceedings so as to prevent the enforcement of the lien or forfeiture of any part of the homestead property; or
 - (d) secures from the holder of the lien an agreement satisfactory to the lender subordinating the lien to all amounts secured by the lender's lien on the homestead property;
- σ② Provision B of Section 50, Article 16 of the Texas Constitution (k)(6) remains the same, triggering repayment of the loan if the homestead property is sold or otherwise transferred.

- ♂② Provision C is a change from a prior provision requiring repayment if all the borrowers ceased occupying the homestead property as a principal residence for more than 180 consecutive days and the location of the homestead property owner was unknown to the lender. This effectively permitted a borrower to avoid repayment by simply notifying the lender of the borrower's new address. This provision alone was sufficient to keep most lenders out of the reverse mortgage market.
- ♂② Provision A is the obvious, possibly implied, but death of all of the borrowers is now clearly a condition requiring repayment.
- ♂② Finally, Provision D is a normal lender right. Essentially, the lender needs protection of its collateral. This provision creates that right and the concomitant duty by the borrower to preserve and protect the collateral and lien position.

III. CHANGES TO PERMITTED LIENS

F. REVERSE MORTGAGES

2. New Disclosure Requirements

- ♂② The new Constitutional Amendment added disclosure requirements in (k)(9) that requires the lender, at the time the loan is made, to disclose to the borrower by written notice the specific provisions contained in Subdivision (6) which trigger the requirement to repay.

3. New Qualifying Age

- ♂② The qualifying age for reverse mortgages was changed from 55 years to 62 years or older.

III. CHANGES TO PERMITTED LIENS

F. REVERSE MORTGAGES

4. Advances Expanded

♣② Subdivision (p) also expanded the methods for advances under reverse mortgage loans to include, if set out in the loan documents,:

- (1) at regular intervals (prior law);
- (2) at regular intervals in which the amounts advance may be reduced, for one or more advances, at the request of the borrower; or
- (3) at any time by the lender, on behalf of the borrower, if the borrower fails to timely pay any of the following that the borrower is obligated to pay under the loan documents to the extent necessary to protect the lender's interest in or the value of the homestead property:
 - (B.) taxes;
 - (C.) insurance;
 - (D.) costs of repairs or maintenance performed by a person or company that is not an employee of the lender or a person or company that directly or indirectly controls, is controlled by, or is under common control with the lender;
 - (E.) assessments levied against the homestead property; and
 - (F.) any lien that has, or may obtain, priority over the lender's lien as it is established in the loan documents.

♣② Note that if the lender fails to make loan advances as required in the loan documents after notice from the borrower, the lender forfeits all principal and accrued interest.

♣② This death penalty does not apply when a government agency or instrument takes an assignment of the loan in order to cure the default.

III. CHANGES TO PERMITTED LIENS

F. REVERSE MORTGAGES

5. New Foreclosure Requirements

- σ② In Subparagraphs (k)(10) and (11), a provision was added that required the lender to give notice, by mail, of the default and give a 30-day cure period (or 20 days in the event of a default under Subdivision (6)(D)(iii)). As an alternate to curing the default, the borrower may pay the debt secured by the homestead property, or convey the homestead property to the lender by deed in lieu of foreclosure.
- σ② Only a default under Paragraphs (6)(A) and/or (B) may be foreclosed by non-judicial foreclosure.
- σ② Subparagraph (r) of the amendment requires the Supreme Court to promulgate rules of civil procedure for the expedited foreclosure of reverse mortgage lien, when a court order is required.

IV. CHANGES TO REFINANCE

A. OVERBURDENING PERMITTED

- ♣② S.J.R. No. 22 amended Section 51, Article XVI of the Texas Constitution to eliminate the age-old problem of overburdening of the homestead created by refinance or partial release. See John Hancock Mutual Life Ins. Co. v. Glasgow, 141 S.W.2d 942 (Comm App. 1940). In the past, if the lien securing a debt was altered upon refinance or release such that the debt against the remaining homestead was greater on a pro rata dollar per area basis, this was an impermissible overburdening. This was in spite of relative differences in value per parcel, particularly where improvements might be involved.
- ♣② Specifically, the Constitutional Amendment provides as follows:

Provided further that a release or refinance of an existing lien against a homestead as to a part of the homestead does not create an additional burden on the part of the homestead property that is unreleased or subject to the refinance, and a new lien is not invalid only for that reason.

B. SPREADING PERMITTED

- ♣② The Legislature, for unknown reasons, also determined to permit spreading of the homestead lien in connection with refinance. Senate Bill 496, effective September 1, 1999, amended Texas Property Code, Section 5.042(a) as follows:

and the doctrine or rule prohibiting an existing lien upon part of a homestead from extending to another part of the homestead not charged with the debts secured by the existing lien upon part of the homestead do not apply in this State.

- ♣② For whatever reason, the Legislature did not feel a Constitutional Amendment was necessary in connection with spreading and the change was enacted by statute only. Whether or not this is a Constitutional problem remains to be seen.
- ♣② For the common law prohibition, see Baxter v. Crow, 133 S.W. 2d 187 (Tex. Civ. App. - San Antonio 1939, writ dism'd judgm't cor.).

IV. CHANGES TO REFINANCE

C. REFINANCE OF A MANUFACTURED HOUSING UNIT PURCHASE MONEY LIEN

- ♂② House Bill 1086 amended the Property Code to add Chapter 62, effective September 1, 1999, regarding manufactured homes. Section 62.004 specifically addresses refinancing of liens. The following items are needed to refinance a purchase money lien against a MHU:

Certificate of Attachment (Texas Property Code 2.001(b))

Release of UCC-1 Financing Statement

Certified copy of Note and Security Agreement

Written pay-off amount

Deed of Trust language as follows:

"Being a renewal, extension and conversion of a lien on a manufactured housing unit pursuant to Chapter 62, Texas Property Code."

- ♂② Note that the refinance may include the purchase money lien on the land.
- ♂② Prior retail installment liens should also be referenced, renewed and extended in the deed of trust. If not of record, it should be obtained from the lender when the pay-off is made and retained in the GF for proof of subrogation.
- ♂② These loans should be checked with your underwriter as some underwriters will not insure, based upon a concern that the lien is an impermissible constitutional burden on the homestead.

IV. CHANGES TO REFINANCE

D. REASONABLE COSTS NECESSARY TO REFINANCE DEFINED?

- σ② The Texas Department of Insurance took steps to better define permissible costs incurred in connection with a refinance. Commissioner Elton Bomer issued Commissioner's Bulletin No. B-0008-98 Title Bulletin No. 159, which is misnamed "The Recent Constitutional Amendment on Home Equity Loans". Home Equity Loans specify a 3% cap on reasonable and necessary expenses in connection with a Home Equity Loan.
- σ② The legislative history indicates that no change to the law was intended and goes further to adopt the prior case law set out in In re Freytag, 155 B.R. 150 (Bkrtcy. N.D. Tx 1993) and Machicek vs. Barcak, 141 Tex. 165, 170 SW 2d 715 (1943) which permitted direct costs incurred in connection with a refinance.
- σ② Representative Wolens stated in discussion, "If the amendment is not intended to alter the process, then the direct costs incurred in the refinance, including impounds, reserve or escrow for insurance and taxes, should be 'reasonable costs necessary to refinance such debt.'"..."It's only if you are taking additional money out and putting it in your pocket." House Floor debate, May 9, 1997 (tape 141).
- σ② In In re Freytag there was no advance of new funds or alteration of the basic debt, and permitted costs included fees for loan origination, loan brokers' fees, reserve for future taxes, reserve for future insurance premiums, title insurance costs, appraisal fees, attorneys' fees, prepaid interest, survey costs, settlement fees, recording fees, and a tax search fee. A copy of the Bulletin follows.
- σ② Care should still be taken, as the Texas Attorney General has questioned the precedential value of commentary or guidance by state agencies. See Op. Tex. Att'y Gen. DM-495 (1998).

V. CHANGES IN TITLE INSURANCE

A. (a)(6) HOME EQUITY LOANS

- ♫② In addition to the coverage previously provided for Home Equity Loans pursuant to Rule P44 and Endorsement Form T42, coverage has been expanded pursuant to Rule P47 and T42.1. Copies of these Procedural Rules and Endorsements are attached. As you will note, not all the requirements of (a)(6) are covered. The attached chart reflects the coverages available and not available, and related underwriting requirements.
- ♫② **Form T-42, Equity Loan Mortgage Endorsement.** This Endorsement was adopted for use with home equity mortgages beginning on January 12, 1998, the first day on which such a mortgage could be lawfully executed under the constitutional amendment approved by Texas voters in 1997. This Endorsement is mandatory for inclusion with any Form T-2 Mortgagee Policy that insures a lien securing an extension of credit made under Section 50(a)(6), Article XVI, TEXAS CONSTITUTION.
- ♫② **Form T-42.1, Supplemental Coverage Equity Loan Mortgage Endorsement.** This form became available on November 12, 1998, and is optional for use with a Mortgagee Policy insuring the lien of a home equity mortgage. This Endorsement supplements the Form T-42 and, by its terms, is void and of no effect if attached to a Mortgagee Policy lacking a Form T-42 Endorsement.
- ♫② The Form T-42.1 Endorsement adds eleven more items to the list of covered matters otherwise excluded by the "consumer credit protection law" definition inserted into the Mortgagee Policy by the Form T-42.
- ♫② Arguably, for the first time, the industry is insuring what is "homestead". (Paragraph 1(i), "Part of the land described in Schedule A not being the homestead of the owner.")
- ♫② **Rate Rule R-28.** This Rule establishes the premiums chargeable for the Form T-42 and T-42.1 Endorsements. From January 12, 1998, through November 11, 1998, the Form T-42 Endorsement was not premium-bearing. Beginning on November 12, 1998, the premium for the Form T-42 is set by Rule R-28 to be 10% of the Basic Premium Rate for the amount of the Mortgagee Policy being endorsed. The premium for the Form T-42.1 Endorsement is 15% of the Basic Premium Rate for the associated Mortgagee Policy. "Basic Premium Rate" means the scheduled/calculated premium for the Policy, according to the currently promulgated Schedule of Basic Rates, exclusive of other charges for additional coverages (such as "tax deletion" or "not yet due

and payable") and before application of any refinance credit due under Rate Rule R-8.

V. CHANGES IN TITLE INSURANCE

B. REVERSE MORTGAGES

- ♣② Texas Reverse Mortgage Endorsement Form T43 remains in place, by which endorsements can be issued upon satisfaction of Procedural Rule 45. The title insurance industry and the Department of Insurance have not had an opportunity to respond to the recent Constitutional Amendments. A new form may well be required. However the coverage provided in T43 does not take exception to new disclosure and foreclosure provisions (k)(9), (10) and (11). Underwriters may take special exception pursuant to Schedule B of the Title Policy or may choose to insure these provisions.
- ♣② Note that there is currently no Rate Rule for issuance of a T43 endorsement, and consequently no premium.
- ♣② **Texas Reverse Mortgage Endorsement.** This Endorsement became available on January 12, 1998.
 - ♣② **Form T-43 Endorsement.** The Endorsement is designed to provide progressively increasing coverage under a Mortgagee Policy insuring a reverse mortgage on homestead property under Section 50(a)(7), Article XVI, TEXAS CONSTITUTION. The policy can be issued up to 150% of the anticipated total advances under the loan agreement.
 - ♣② Paragraph No. 1 of the Endorsement is similar to the "pending disbursements" clause used in Mortgagee Policies insuring liens for construction. Up to the amount stated in Schedule "A" of the Policy, the Endorsement initially limits coverage to loan proceeds actually advanced on the Policy's date, and provides for automatic increases in the amount of coverage as additional loan proceeds are subsequently disbursed and as unpaid interest accrues. However, this progressively increasing coverage is limited to disbursements made by the lender-insured in good faith and without knowledge of defects in or objections to title.
 - ♣② Paragraph No. 2 of the Endorsement insures that covered subsequent disbursements of loan proceeds and accrued interest will have the same priority as funds advanced on the Policy's date, except with respect to any bankruptcy occurring prior to disbursement and excluding taxes or other governmental obligations secured by statutory liens arising or filed subsequent to the Policy's date.

- ♂② Paragraph No. 3 of the Endorsement gives affirmative insurance against loss suffered from invalidity or unenforceability of the insured mortgage which results from failure of the mortgage to have been created under a written agreement with consent of each owner and owner's spouse.
- ♂② Paragraph No. 4 of the Endorsement excludes coverage against claims of usury or violation of consumer credit protection laws, including various subsections of Section 50(k). It also excludes liability for costs, expenses, or attorney's fees incurred in determining the amount of interest of other indebtedness owing and secured by the reverse mortgage. "Interest" is defined within the Endorsement as including compound interest, interest on interest, and interest contingent on market value appreciation if charged in accordance with the terms of the insured mortgage.
- ♂② It also remains to be seen if the lending industry will embrace reverse mortgages pursuant to the amendments. The legislature and the constitutional amendment failed to address the definitional difficulties presented by (k)(8), requiring "counseling regarding the advisability and availability of reverse mortgages and other financial alternatives."

C. LIMITED COVERAGE JUNIOR MORTGAGEE POLICIES

- ♂② Forms and rules adopted by the Commissioner of Insurance in November, 1998, also included the following: Form T-44, Texas Residential Limited Coverage Junior Mortgagee Policy; Form T-45, Texas Residential Limited Coverage Junior Mortgagee Policy Down Date Endorsement; Form T-46, Texas Residential Limited Coverage Junior Mortgagee Policy Variable Rate Endorsement; Form T-3, Texas Residential Limited Coverage Junior Mortgagee Policy Additional Coverage Endorsement; and Procedural Rule P-46, covering issuance of all of the foregoing forms. The intended purpose of this Limited Coverage Policy and related endorsements was to provide a lower-cost alternative for home equity loans of \$100,000 or less being made by institutional lenders and secured by junior liens on residential property. The policy essentially provided an insurance type product insuring current title to the property. However, the Commissioner was unable to adopt premium rates for this Policy and Endorsements. **Consequently, the forms are not presently available for issuance in Texas.**

V. CHANGES IN TITLE INSURANCE

D. AD VALOREM TAX - SUBSEQUENT ASSESSMENTS

- ♣② The Texas Legislature also took steps to make it clear that title insurance policies provide coverage for ad valorem tax subsequent assessments. Texas Insurance Code Article 9.07A was amended as follows:

For an owner policy on residential real property that is issued to a natural person, the commissioner may adopt coverages that insure against: (1) ad valorem taxes, including penalties and interest, to be paid with respect to the property for a previous tax year and that are delinquent on the effective date of the policy because of sale, diversion, or change of use, unless excluded because the insured has actual knowledge of the delinquent taxes; and (2) ad valorem taxes, including penalties and interest, to be paid with respect to the property for a previous tax year because of an exemption granted to a previous owner of the property under Section 11.13, Tax Code, or because of improvements not assessed for a previous tax year, unless excluded because the insured has actual knowledge of the taxes.

- ♣② This bill is intended to result in tax coverage in residential owner policies for subsequent assessments based on the removal of prior year incorrectly claimed exemptions. The commentary provides: "Under the Tax Code, a homeowner is entitled to claim a homestead exemption from school ad valorem taxes. In addition, any person age 65 years or older is entitled to an additional exemption from school taxes on a residential homestead. To receive the exemption, a person claiming the exemption must apply for it by filing an exemption application form with the chief appraiser for each appraisal district in which the property subject to the claim exemption is located. After considering the application, the chief appraiser determines whether to approve or disapprove the application. Even if the chief appraiser approves the application, the law requires an investigation if any reason materializes that indicates that an exemption previously allowed should be canceled. If the chief appraiser discovers that the property escaped taxes, the exemption is canceled and the school district is entitled to impose taxes, penalties, and interest on the property or value that escaped taxation. Many times, new homeowners and title companies are unaware of any improprieties concerning erroneous claims for homestead exemptions. Nonetheless, if a person purchases a residential homestead encumbered with delinquent taxes, penalties, and interest due to an invalid exemption, that person, rather than the former owner, must pay since delinquent taxes, penalties, and interest are levied against the property, rather than the owner."
- ♣② H.B. 1453 states that the commissioner may adopt coverages which require a title insurance policy to indemnify against ad valorem taxes for prior years, including subsequent assessments for the removal of exemptions or untaxed improvements, though not yet delinquent, and including penalties and interest, if the purchaser did not know

about the delinquent tax or tax lien at the time of the purchase. This coverage has now been adopted, effective January 1, 2000.

- ♂② The Department of Insurance has also issued an enforcement action to assure that the coverage for subsequent assessment exists. See Official Order of the Commissioner of Insurance of the State of Texas, Consent Order, Docket No. C-98-0923, March 5, 1999.

- ♂② The Department alleged that the Schedule B exception did not apply to the claims denied by the title company. "The policy language was added to the title policy by the State Board of Insurance in 1980. The language was added to exclude from coverage deferred taxes that become due and payable upon the sale of land or change in its use caused by the difference in assessed value between agricultural use and true market value, as provided by Tex. Tax Code Ann., Title 1, §23.46(c). The language was not intended to exclude from coverage taxes assessed as a result of a homestead or over-age 65 exemption that has been improperly claimed by a prior owner."

- ♂② The title company was charged with violating Tex. Ins. Code Ann. Article 21.21-2 § 2(b)(4) by not attempting in good faith to effectuate prompt, fair and equitable settlements of claims submitted in which liability had become reasonably clear. "The liability of the title company regarding these claims was clear from the text of the policy exception. "The record consists of the agenda for and transcripts of hearings of the State Board of Insurance in 1979 in which the reasons for the promulgated policy language were discussed by board members as well as witnesses at the hearing. The record demonstrates that the Department's interpretation of its policy has consistently reflected the intent of the State Board of Insurance in adopting the policy language. Further, other title insurers have paid claims consistent with that interpretation in circumstances described in paragraph 1 herein."

- ♂② The above described conduct of the title company was alleged to violate the *Texas Insurance Code* provisions applicable to those engaged in the business of insurance in the State of Texas. "TEX. INS. CODE ANN. Art. 1.10 § 7 authorizes the Commissioner of Insurance to sanction certificate of authority holders as well as to impose monetary penalties more fully described in TEX. INS. CODE ANN. Art. 1.10 upon a finding that certificate of authority holder has violated the *Texas Insurance Code* or your duly promulgated rules. The Staff of the Texas Department of Insurance, by and through Staff Attorney, Jack Woods, recommends that the title company be assessed a penalty in the amount of \$20,000 for the conduct alleged in paragraph 1 above. The Staff further recommends that the Commissioner issue a cease and desist order enjoining the title company from the acts set forth in paragraph 1 herein."

- ♂② However, in the meantime, at least one District Judge in Dallas County has preliminarily indicated that the appraisal district may not remove exemptions in such a manner as to

create a subsequent assessment lien against a bona fide purchaser. Hamilton, et al v. Dallas Central Appraisal District, DV 98-07689, 192nd District Court, Dallas County.

VI. CONCLUSION

♂② In general, Constitutional and Legislative changes in 1999 expanded the ability of homeowners to borrow against the equity in their home. Some changes also created more flexibility in borrowing funds and imposing supporting liens. Thus, urban homestead has been expanded to ten acres and separate business property, previously considered homestead, may be freed up for traditional borrowing. The legislature also took steps to address concerns regarding refinancing, particularly as to overburdening, spreading and manufactured housing units. Finally reverse mortgages may now become a viable means of borrowing funds. The lending and title insurance industry response remains to be seen. The Constitutionality of spreading and, to a lesser degree, refinance and manufactured housing units also remains to be tested in the courts.

APPENDIX

- A. SJR 22 - Homestead; Texas Constitution, Article XVI, Section 51
- B. SB 496 - Homestead - Texas Property Code, Chapter 41
- C. SJR 12 - Reverse Mortgages, Texas Constitution, Article XVI, Section 50
- D. HB 1086 - Manufactured Housing, Texas Property Code, Chapter 62
- E. Texas Department of Insurance - Commissioner's Bulletin No. B-0008-98; Title Bulletin No. 159: *The Recent Constitutional Amendment on Home Equity Loans*
- F. P-44. Equity Loan Mortgage Endorsement (T-42)
- G. Equity Loan Mortgage Endorsement T-42
- H. P-47. Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1)
- I. Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1)
- J. Matrix for Home Equity §50(a)(6) Loans
- K. Checklist for Coverages - T-42 Equity Loan Mortgage Endorsement; T-42.1 Supplemental Coverage Equity Loan Mortgage Endorsement
- L. Home Equity Related Schedule "B" Exceptions; Schedule "C" Requirements
- M. P-45. Texas Reverse Mortgage Endorsement (T-43)
- N. Texas Reverse Mortgage Endorsement T-43

I. SJR 22 - Homestead; Texas Constitution, Article XVI, Section 51
insert SJR 22 (page 1)

insert SJR 22 (page 2)

II. SB 496 - Homestead - Texas Property Code, Chapter 41
Insert SB 496 (page 1)

Insert SB 496 (page 2)

Insert SB 496 (page 3)

Insert SB 496 (page 4)

Insert SB 496 (page 5)

III. SJR 12 - Reverse Mortgages, Texas Constitution, Article XVI, Section 50
Insert SJR 12 (page 1)

Insert SJR 12 (page 2)

Insert SJR 12 (page 3)

Insert SJR 12 (page 4)

Insert SJR 12 (page 5)

Insert SJR 12 (page 6)

IV. HB 1086 - Manufactured Housing, Texas Property Code, Chapter 62
Insert HB 1086 (page 1)

Insert HB 1086 (page 2)

- V. Texas Department of Insurance - Commissioner's Bulletin No. B-0008-98; Title Bulletin No. 159: *The Recent Constitutional Amendment on Home Equity Loans*

Insert

insert V page 2

VI. P-44. Equity Loan Mortgage Endorsement (T-42)
insert page 1

VII. Equity Loan Mortgage Endorsement T-42
insert VII page 1

VIII. P-47. Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1)

insert VIII page 1

insert VIII page 2

insert VIII page 3

insert VIII page 4

IX. Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1)

Insert IX page 1

Insert IX page 2

X. Matrix for Home Equity §50(a)(6) Loans
Insert X page 1

Insert X page 2

Insert X page 3

Insert X page 4

XI. Checklist for Coverages - T-42 Equity Loan Mortgage Endorsement; T-42.1
Supplemental Coverage Equity Loan Mortgage Endorsement

Insert XI page 1

Insert XI page 2

Insert XI page 3

Insert XI page 4

Insert XI page 5

XII. Home Equity Related Schedule "B" Exceptions; Schedule "C" Requirements

insert XII page 1

insert XII page 2

insert XII page 3

XIII. P-45. Texas Reverse Mortgage Endorsement (T-43)
insert

XIV. Texas Reverse Mortgage Endorsement T-43

insert XIV page 1

insert XIV page 2

REFERENCES

Many other articles are of assistance in evaluating homestead issues. There is a wealth of material available, and I would highly recommend the following:

<u>Title</u>	<u>Author</u>
<i>Refinancing the Homestead Lien</i>	Chris A. Peirson, Texas Land Institute, 1991
<i>Homestead Issues</i>	Charles J. Jacobus, Texas Land Institute, 1992
<i>Homestead Case Update</i>	Ginny Abiassi, Texas Land Institute, 1993
<i>Homestead Case Update</i>	Aloysius L. Leopold, Texas Land Institute, 1994
<i>Homestead Issues</i>	Charles J. Jacobus, Texas Land Institute, 1996
<i>New Homestead Issues</i>	Charles J. Jacobus, Texas Land Institute, 1997
<i>Texas Home Equity Title Insurance Product Line Loan Origination Through Foreclosure</i>	Tommy Bastian and Steve Lawrence, Texas Land Institute, 1998
<i>Pitfalls (and Pratfalls) of Texas Home Equity Lending</i>	TLTA Home Equity Seminar, 1998
<i>Texas Homestead Selected Topics and Cases</i>	G. Roland Love, Agency Seminar, Old Republic National Insurance Company, 1999
<i>Mastering Real Estate Titles and Title Insurance in Texas</i>	Steve G. Lawrence and G. Roland Love, National Business Institute, 1999
<i>Homestead Update</i>	Steven C. Haley, Mortgage Lending Institute, 1999
<i>Home Equity Update</i>	Stephen A. Hester, Jr., Mortgage Lending Institute, 1999