UNIT 13
TEXAS EQUITY LOANS, HELOCS, REVERSE MORTGAGES, AND FORECLOSING HOMESTEAD PROPERTY

INTRODUCTION

This Unit describes the rules that must be followed when providing home equity loans, HELOCs, and reverse mortgages to homeowners of Texas homestead property. [TX Const. Art. 60 §50 and 7 TAC Chapters 151, 152, and 153]. It also describes the procedures related to foreclosing on home equity loans. [TX Rules of Civil Procedure 735 and 736].

Learning Objectives

After reading this Unit, you should be able to:

- recall the Texas homestead law and its purpose.
- recognize the required elements for equity loans and when the consumer disclosure is provided.
- identify HELOCs and the requirements for HELOCs on homestead property.
- indicate the types of reverse mortgages.
- recall the requirements for an FHA home equity conversion mortgage.
- recognize the procedures that need to be followed in order to foreclose on homestead property in Texas.

INTRODUCTION TO TEXAS HOMESTEAD LAW

What is a Homestead?

In Texas, a **homestead** is a legal status for real property created by the Texas Constitution found in The Texas Constitution in Article 16, Sections 50, 51, and 52. Because homestead rights are constitutional, an owner cannot waive them by any agreement. An **owner** is defined as a person who has the right to possess, use, and convey, individually or with the joinder of another person, all or part of the homestead. [TAC Rule §153.1 (13)]. A homestead generally consists of the home, fixtures and land that a person occupies as a residence. Either separate or community property may constitute a homestead.

Urban and Rural Homesteads

Texas makes distinctions between an urban and rural homestead. An **urban homestead** is a property that is located within a municipality and is served by police and fire protection as well as three of the following municipality services: electric, gas, sewer, storm sewer, and water. Since 1999, the urban homestead is limited to ten acres. More than one lot may be designated as a person's urban homestead provided that the lots are contiguous and all lots making up the urban homestead do not exceed the ten acre limitation. [Prop. Code §41.002]. An urban homestead may be used for business purposes as long as the property is used as an urban home. [Prop. Code §41.002(a)]. A **rural homestead** has size limitations—100 contiguous acres for a single adult or 200 contiguous acres for a family.

Requirements for a Valid Homestead

Since owning a homestead is a legal right in Texas, no paperwork or documentation is required. However, if a person wants to take advantage of the homestead tax exemption to reduce the amount of property tax owed, he or she would file an Application for Residential Homestead Exemption. This is for property tax reduction purposes only, and is not required to establish a legal homestead.

To establish a homestead, the person claiming homestead protection must show a combination of (1) **intent** to use the land as a permanent residence and (2) **overt acts** consistent with usage of the land as a home. Only one homestead may be valid at any one time per individual or family.

Sometimes a homeowner is requested to execute an affidavit indicating whether the person intends for a particular parcel to be homestead. Such affidavits are frequently used to resolve uncertainty, such as when the person owns multiple residential properties, or when the person's home is situated on a parcel of land that is larger than the maximum homestead size. Such affidavits simply serve to clarify the person's intent; they are not required to establish the homestead.

How is a Homestead Terminated?

Homestead protection lasts indefinitely until there is solid proof of transfer, abandonment, or death. Generally, both spouses must join in any transaction to transfer or encumber a homestead. An owner of the property claimed as homestead may not sell or abandon the homestead without the consent of each owner and the spouse of each owner. [TX Const. §50(b)].

A temporary absence from the home or temporarily renting the property are not considered abandonment and will not end homestead protection provided the owner does not establish another homestead elsewhere. [TX Const. §51]. Evidence establishing the abandonment of a homestead must be undeniably clear that there has been a total abandonment with an intention not to return. **Abandonment** is deserting the property with the intent not to occupy the property as one's residence. A declaration of abandonment can be filed, but is not necessary.

Homestead status affects the disposition of property upon death. For example, a surviving spouse and minor (or unmarried) children may be entitled to continue to occupy a homestead even if the decedent's will states otherwise. [TX Const. §52]. In the event of divorce, each party may establish his or her own homestead.

What is the Effect of Homestead on Liens?

Homestead rights protect property from all but the few types of constitutionally permitted liens that may be imposed against a homestead. This means that homesteads cannot be foreclosed upon to pay off debts incurred by any member of the family, except for the payment of specific types of debts.

Debts Not Protected From Forced Sale

- Purchase money loan on the homestead
- Tax liens on the homestead
- Mechanic's liens (only if contract was signed by both husband and wife) for work or services performed on the homestead
- Refinancing of liens against homestead
- Owelty of partition (divorce or probate). An **owelty of partition** is the amount that one co-owner must pay to another after a lawsuit to partition real estate, so that each co-owner receives equal value from the property.
- Home equity loan on the homestead
- Reverse mortgage on the homestead

Section 50(e) states that a refinance of an existing mortgage transaction that includes the advance of additional funds may not be secured by a valid lien against the homestead unless the refinance complies with Section 50(a)(6) or the advance of all the additional funds is for reasonable costs necessary to refinance the debt, or for taxes, owelty of partition, or home improvement. **Reasonable and necessary costs** are those costs which are lawful and may include reserves or impounds (escrow trust accounts) for taxes and insurance (if the reserves comply with applicable law). [TAC Rule §153.41].

A Texas homestead is not, however, secure from seizure for a debt owed to the federal government, or from an encumbrance existing on land prior to its dedication as a homestead.

Homestead Protects Against a Forced Sale

The Texas Constitution has protected homesteads from forced sale for over 175 years. The Constitution enumerates the permissible encumbrances on a homestead, which are: (1) purchase money; (2) taxes; (3) an owelty of partition; (4) the refinance of a lien (including federal tax liens), (5) home improvements, (6) an equity loan, and (7) a reverse mortgage on a homestead. [TX Constitution Article 16 §50(a)(1-7)].

Section 50 addresses only the elements necessary to create a valid lien on a homestead. The actual legality of the credit transactions and loans are covered under different statutes and constitutional provisions.

For example, the Texas Constitution Section 11, Article XVI permits interest rates of 10% or less on credit transactions. Then it states that the Legislature may provide alternative interest rates and classify loans, which it did in Title 79 of the Texas Civil Statutes and in Titles 3 and 4 of the Texas Finance Code. A mortgage loan's classification regarding the appropriate treatment under credit law hinges upon the lien position. A first lien mortgage loan is governed by the provisions of Title 79 (Subtitle I). A second mortgage loan that exceeds the constitutional rate of 10% interest falls within the jurisdiction of Title 79 (Subtitle II).

EQUITY LOANS

Section 50(a)(6), Article XVI, of the Texas Constitution allows certain loans to be secured against the equity in a person's home, commonly known as equity loans. An **equity loan** (extension of credit) is defined in section 50(a)(6), Article XVI of the Texas Constitution. The definition of an equity loan includes approximately 26 elements, each of which must be satisfied to be an equity loan. Each requirement under Section 50(a)(6) is necessary to have a valid lien on the homestead.

If a lender meets all of the required elements when making an equity loan, it has the right to foreclose and sell the property if the borrower does not repay or meet the terms of the loan. However, a lender that fails to comply with the requirements for a valid equity loan may forfeit of all principal and interest on the loan. A purchaser at a foreclosure sale (not the lender or assignee) may presume that the foreclosed lien securing the homestead property was a valid equity loan. [TX Const. Article 16 §50(i)].

Required Elements for an Equity Loan

(A) Voluntary Lien

The home equity transaction must be voluntary and must be entered into under a written agreement executed with the consent of each owner and each owner's spouse. Regardless of whether a spouse has a community property interest in the homestead, the consent of that spouse must be obtained. [TAC Rule §153.2]. A spouse or owner who is not a maker of the note may acknowledge his or her consent by executing a written consent to the mortgage instrument.

(B) Limitation on Loan Amount

The amount of the loan is limited to an amount including the aggregate total of outstanding debt against the homestead that does not exceed **80% of the fair market value** of the homestead on the date the loan is closed. [TAC Rule §153.3]. Thus, the limitation applies to the cash advance and charges at the inception, to the extent any charges are financed in the principal amount of the loan. The determination of the maximum principal amount of the equity loan is based upon the principal balance outstanding on the date the extension of credit is made and does not include interest accrued after the date the extension of credit is made (other than any interest capitalized and added to the principal balance on the date the extension of credit is made), or other amounts advanced by the lender after closing as a result of default, including for example, ad valorem taxes, hazard insurance premiums, and authorized collection costs, including reasonable attorney's fees. On a closed-end multiple advance loan, the principal balance also includes contractually obligated future advances not yet disbursed.

> Example: A property has a fair market value of $100,000 and existing debt on the property of $30,000. The maximum amount of debt against the property could be $80,000. Subtracting the outstanding debt of $30,000, the maximum amount of the new equity loan debt would be $50,000 on the date the loan is made.

(C) Nonrecourse

The loan is made without recourse for personal liability of each owner and each owner's spouse unless the owner or spouse has committed actual fraud in obtaining the loan. In essence, a lender may not pursue a deficiency against any owner or any owner's spouse for any unpaid amounts, except in cases of actual fraud. Texas case law distinguishes 'actual fraud' from 'constructive fraud'. **Actual fraud** encompasses dishonesty of purpose or intentional breaches of duty that are designed to injure another or to gain an undue and unconscientious advantage. [TAC Rule §153.4].

(D) Foreclosed Upon Only By A Court Order

The homestead property can be secured by a lien that may be foreclosed upon only by a court order.

(E) Limitation on Fees

An equity loan must not require the owner to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, 3% of the original principal amount of the extension of credit. [TAC Rule §153.5].

Interest and Fees

A borrower may not be required to pay fees, in addition to any interest, in excess of 3%. The language specifically excludes interest from the limitation. For example, charges that constitute interest under the law, include points, which are not fees subject to the 3% limit. Fees that are required to be paid and that are not interest are subject to the 3% limitation. There is no restriction on a lender absorbing costs that might otherwise be fees and, therefore, covered by the fee limitation.

Voluntary Optional Fees

Charges that are not imposed by the lender, but that are optional, are not fees subject to the 3% fee limit. For example, the fee a borrower pays for premiums for insurance coverage that is not required as a condition to obtain the equity loan, is not subject to the limitation. Credit life and credit accident and health insurance coverage, if elected by the owner, are not included within the 3% limitation. However, if credit life and credit accident and health insurance were required by the lender then these charges would be included in the 3% limitation.

Fees to Originate an Equity Loan

Fees to originate an equity loan that are not interest fall within the 3% limitation. Fees to third parties for separate and additional activities relating to originating a loan, also fall within the limitation. For example, attorney's fees for document preparation are fees necessary to originate the loan. A broker's fee is also considered to be a fee to originate the loan.

Fees to Evaluate the Credit Decision for an Equity Loan

Fees to evaluate the credit decision for an equity loan that are not interest are subject to the 3% limitation. This includes fees collected to cover the expenses of a credit report, survey, flood zone determination, tax certificate, title report, or appraisal.

Fees to Maintain an Equity Loan

Fees to maintain the equity loan that are not interest are subject to the 3% limitation. This encompasses a fee charged at the inception of the loan to compensate for performing a service for the life of the loan. Examples of this fee are a flood zone determination fee and a tax service fee.

Fees to Record an Equity Loan

Fees paid to public officials and others for the purpose of recording public documents evidencing the lien are fees subject to the 3% limitation.

Fees to Insure an Equity Loan

Premiums to insure the equity loan are fees subject to the 3% limitation. Title insurance and mortgage insurance protection are examples of this type of fee.

Fees to Service an Equity Loan

Any fee charged to and paid by an owner at the inception of the loan transaction to service the equity loan that is not interest is subject to the 3% limitation.

Escrow Funds

A lender may provide escrow services in a home equity transaction. Funds tendered by the borrower into an escrow account such as for the purpose of taxes, insurance premiums, maintenance or homeowner's association assessments, or similar purposes remain the property of the borrower. Hence, these funds are not subject to the 3% limitation. A lender should not contract for a right of offset against escrow funds pursuant to Section 6(H).

Subsequent Events

The 3% limitation pertains to fees charged to or paid by the owner at the inception of the loan. The lender and owner agree to certain covenants to be performed by both parties after the consummation of the transaction. The parties have a responsibility to perform their respective obligations under the contract after the transaction has been consummated.

If the owner fails to perform, certain events may be triggered that involve the assessment of costs to the owner. One example is the maintenance of homeowner's insurance on the homestead. This type of insurance coverage is normally maintained on all homesteads regardless of whether there is a loan on the property. Certainly, lenders may require borrowers to ensure that a homestead has adequate insurance protection. If the owner fails to maintain homeowner's insurance, the owner has not performed according to the covenants of the agreement. The lender may purchase insurance, called **force-placed insurance**, to maintain coverage on the collateral. [TAC Rule §153.1 (10)]. This is a subsequent event and is not included in the 3% limitation.

Another example is the assessment of late charges. The assessment of these charges is a subsequent event and arises because of the owner's failure to perform under the agreement. Thus, these charges are not contained within the 3% limitation. Other examples of charges associated with subsequent events are returned check fees, collection costs, and costs associated with foreclosure.

Second Mortgage Loans

A **second mortgage loan** is limited to the types of fees that may be charged in connection with the loan. A lender must comply with the provisions of the law in connection with a second mortgage loan.

Insurance Premiums

A lender may collect or include in the principal premiums or fees for the sale of insurance on the collateral of an equity loan assuming the lender complies with the rest of the terms of HJR 31 and applicable law concerning the sale of insurance in connection with a mortgage loan.

(F) No Open-End Credit

The amendment provides that an equity loan may not be in the form of an open-end account that may be debited from time to time or under which credit may be extended from time to time, unless the open-end account is an open-end line of credit. An **open-end account** is defined in as "an account under a written contract between a creditor and an obligor in connection with which:

(i) the creditor reasonably contemplates repeated transactions and the obligor is authorized to make purchases or borrow money;
(ii) interest may be charged from time to time on an outstanding unpaid balance; and
(iii) the amount of credit that may be extended during the term of the account is generally made available to the extent that any outstanding balance is repaid..." [Article 5069-1B.002(14)].

If an account is not an open-end account by definition, then it must be a **closed-end account**. A common type of closed-end second mortgage loan (Chapter 3A, Subchapter G) is a type of interim construction loan. The loan has multiple advances at particular stages and interest is only charged upon the principal balance outstanding. No interest is charged on funds that have not been advanced. However, credit is not made available to the extent that outstanding balances have been repaid. This distinction makes this type of loan a closed-end transaction.

Closed-end multiple advance equity loans are permissible within the context of this section. The loan should be structured so that the loan is payable in **substantially equal successive monthly installments** until the next advance or adjustment period. Each installment must extinguish the accrued interest and contribute to amortizing part of the principal balance.

(G) No Prepayment Penalties

An equity loan may be paid in advance without penalty or other charge. [TAC Rule §153.7]. A lender may not charge a penalty to a borrower for prepaying a loan or a portion of a loan early. A **lockout provision** in a loan contract (a provision that prohibits a borrower from paying early) is considered to be a prepayment penalty.

(H) No Additional Collateral

An equity loan cannot be secured by any additional real or personal collateral other than the security interest in the homestead. A lender and an owner may enter into an agreement whereby a lender may acquire an interest in items incidental to the collateral.

Items Not Considered Additional Real or Personal Collateral

- Escrow for the payment of taxes and insurance
- An undivided interest in a condominium unit, a planned unit development, or the right to the use and enjoyment of certain property owned by an association;
- Insurance proceeds related to the homestead
- Condemnation proceeds

Items Considered Additional Real or Personal Collateral

A **guaranty or the obligation of a cosigner** or **surety** is considered additional collateral, and would not be permissible in connection with an equity loan. An equity loan document should expressly disclaim and waive any and all other security interests securing any other indebtedness now or thereafter owing to the lender. Additionally, a contractual right of offset is also prohibited under this section.

Lenders are advised to carefully review the legal implications of acquiring a security interest in urban lots that comprise more than ten acres. Any property owned in conjunction with the homestead that is in excess of ten acres is **additional real property**. [TAC Rule §153.8]. The occurrence of urban lots exceeding ten acres does occur in some Texas municipalities.

(I) Property Designated For Agricultural Use Prohibited

An equity loan cannot be secured by homestead property designated for agricultural use as provided by statutes governing property tax, unless the homestead property is used primarily for the production of milk.

(J) Acceleration Prohibited

A lender may not accelerate an equity loan because of a decrease in the market value of the secured property or because the owner defaults on another indebtedness that is not secured by the homestead. However, a lender may accelerate a loan because of an owner's default under the covenants of the equity loan, including covenants not to commit waste or not remove property, which indirectly bear on the market value of the homestead. A contractual cross-default clause is permitted only if the lien associated with the equity loan agreement is subordinate to the lien that is referenced by the cross default clause. A **cross-default provision** is a provision in a loan agreement that puts the borrower in default if the borrower defaults on another obligation. [TAC Rule §153.9].

(K) Limitation on Number of Equity Loans

An owner may have only one equity loan at a time, regardless of the aggregate total outstanding debt against the homestead. If the property ceases to be the homestead of the owner, then the lender may treat what was previously a home equity mortgage as a non-homestead mortgage. A **non-homestead mortgage** is a loan on a property that does not meet the definition of a homestead. [TAC Rule §153.10].

(L) Repayment Schedule

Unless the loan is an equity line of credit, the loan must be scheduled to be repaid in substantially equal successive monthly installments, each of which equals or exceeds the amount of accrued interest as of the date of the scheduled installment. The first monthly installment must begin no later than two months from the date the extension of credit is made. [TAC Rule §153.11].

The second clause does not specifically state that a portion of principal must be reduced with each payment, but in order to have substantially equal installments a portion of the principal must be reduced with each installment. This effectively precludes the permissibility of balloon payments. This provision 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.

(M) Closing Date

A loan may not be closed sooner than **12 days after** the date that the owner applied for the loan or **12 days before** the owner received the required consumer Equity Loan Disclosure (whichever date is later). [TAC Rule §153.12].

The loan may not close without the borrower's consent before one business day after the date on which the borrower receives a copy of the loan application (if not previously provided) and a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. [TAC Rule §153.13]. A **business day** is defined as all calendar days except Sundays and these federal legal public holidays: New Year's Day, the Birthday of Martin Luther King, Jr., Washington's Birthday, Memorial Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, and Christmas Day. [TAC Rule §153.1 (2)]. The submission of an application to the lender also includes the submission to an agent acting on behalf of the lender. An application for a loan may be given orally or electronically and does not have to be in writing.

An equity loan may not be closed before the **first anniversary** of the closing date of any other equity loan secured by the same homestead property. [TAC Rule §153.14(1)]. This provision requires that an equity loan may not be refinanced before one year has elapsed since the loan's closing date.

However, an equity loan may be modified before one year has elapsed since the original 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. The home equity loan and subsequent modification are considered a single transaction. Therefore, a borrower may not receive an advance of additional funds, any new terms must meet the same as of the date of closing of the equity loan, and the 3% fee cap applies. A modification of an equity loan must be agreed to in writing by the borrower and lender, unless otherwise required by law. [TAC Rule §153.14(2)].

(N) Place of Closing

An equity loan may be closed only at an office of a lawfully authorized lender, an attorney at law, or a title company. The lender is anyone authorized under Section 50(a)(6)(P) that advances funds directly to the owner or is identified as the payee on the note. The closing office must be a permanent physical address so that the closing occurs at an authorized physical location other than the homestead. If the transaction is closed at one of these offices, a lender may receive the owner's consent by mail. [TAC Rule §153.15]. A lender may accept a properly executed power of attorney allowing the attorney-in-fact to execute closing documents on behalf of the owner.

(O) Rate of Interest Charged

A lender may charge a fixed or variable rate of interest as authorized by law. A **variable-rate loan** is a mortgage in which the lender, by contract, can adjust the mortgage's interest rate after closing in accordance with an external index. The interest rate on an equity loan must comply with constitutional and applicable law.

An equity loan must amortize and contribute to the reduction of the principal. If the equity loan has a variable interest rate, the scheduled installment amounts must be substantially equal between each interest rate adjustment and be sufficient to cover at least the amount of interest scheduled to accrue between each payment date and a portion of the principal. [TAC Rule §153.16].

(P) Authorized Lenders

An equity loan must be originated by an authorized lender. An authorized lender is defined by statute to be a bank, savings and loan association, savings bank, credit union, or the holder of a regulated loan license. [TAC Rule §153.17]. Unless a lender meets the definitions of (i), (ii), (iv), or (v), the lender must obtain a regulated loan license to meet the provisions of (iii).

> An equity loan may be "made by one of the following that has not been found by a federal regulatory agency to have engaged in the practice of refusing to make loans because the applicants for the loans reside or the property proposed to secure the loans is located in a certain area:
>
> (i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of Texas or the United States;
> (ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans;
> (iii) a person licensed to make regulated loans, as provided by statute of this state;
> (iv) a person who sold the homestead property to the current owner and who provided all or part of the financing for the purchase; or
> (v) a person who is related to the homestead property owner within the second degree of affinity or consanguinity."

Depository Institutions

A bank, savings and loan association, savings bank, or credit union doing business under the laws of Texas or of the United States is defined as an authorized lender.

HUD-Approved Mortgagees

A person approved as a mortgagee by the United States government to make federally insured loans is an authorized lender. The Department of Housing and Urban Development (HUD) approves lenders to make federally insured loans. A HUD- approved mortgagee is entitled to make equity loans as first mortgage loans or second mortgage loans at a rate of interest of 10% or below.

Mortgage Brokers

A mortgage broker must be licensed to make loans. **Making a loan** is the process of determining to extend the credit, the act of funding a loan, or being identified as the payee of the note. If the loan documents recognize a person as making or originating the loan and then the transaction is immediately assigned (often referred to as table funding) to the ultimate lender, both of these lenders (the originator and the funder) must be licensed or otherwise qualify as authorized lenders. A person who only arranges loans does not necessarily fall into this category. Thus, a broker negotiating or arranging second mortgage equity loans at an interest rate greater than 10% must be licensed. A mortgage broker only arranging a first lien equity loan or a cash-out refinance need not be licensed if the broker did not make the loan.

(Q) Equity Loan Conditions

(Q)(1) No Limitation on Application of Proceeds

The owner of the homestead cannot be required to apply the loan proceeds to repay another debt, except debt secured by the homestead, or debt to another creditor. The owner cannot be required to repay to the same lender a non-homestead debt. An owner is entitled to use the proceeds of an equity loan for any lawful purpose, at the owner's discretion. An owner is not precluded from voluntarily paying off a debt that is owed to the same lender, but an owner may not be required to pay off another debt, except a mortgage secured by the homestead which is being refinanced. [TAC Rule §153.18]. A lender should obtain a signed acknowledgment from the owner evidencing the borrower's voluntary repayment of any existing debt if the owner directs that the proceeds should be disbursed directly to existing creditors.

(Q)(2) Cannot Assign Wages as Collateral

The owner of the homestead cannot assign wages as security for the extension of credit.

(Q)(3) No Blanks in the Contract

The owner of the homestead may not sign any instrument in which blanks are left to be filled in. The 'blanks that are left to be filled in' refer to the loan contract terms and not to signature blocks that must be signed to execute the document. This section is intended to protect the owner and prohibits a person (other than the owner) from completing one or more blanks in an instrument after the owner has signed the instrument and delivered it to the lender, thereby altering the owner's obligation created in the instrument. The term **instrument** means a document or record that creates or alters a legal obligation of a party. [TAC Rule §153.20].

(Q)(4) No Confession of Judgment

The owner of the homestead cannot sign a confession of judgment or power of attorney to the lender or to a third person to confess judgment or to appear for the owner in a judicial proceeding.

(Q)(5) Copies of All Documents

At closing, the lender must provide the owner with a copy of all documents that are signed at closing in connection with the equity loan. The lender is not required to give the owner copies of documents that were signed by the owner prior to closing, such as those signed during the application process. [TAC Rule §153.22]. With respect to any documents which, because of their nature cannot be signed at closing, such as a notification of the borrower's election not to rescind under the right of rescission, the lender must provide the owner copies of these documents within a reasonable time after execution. Three business days is a reasonable time for providing these documents to the owner.

(Q)(6) Consumer Loan Disclosure

The security instruments must contain a written notice called the **Consumer Disclosure** stating that the loan is an equity loan subject to section 50(a)(6), Article XVI, Texas Constitution. This disclosure should appear in the mortgage instrument in a way such that it is boldfaced, capitalized, underlined, or otherwise conspicuously set out from the surrounding material. The Consumer Disclosure must be provided to the owner at least 12 days before the date the extension of credit is made. [TAC Rule §153.1(4)].

(Q)(7) Release of Lien

Within a reasonable time after termination and full payment of the loan, the lender must cancel and return the promissory note to the owner and give the owner, without charge, a **release of lien** or a copy of an endorsement and assignment of the lien to another lender refinancing the loan. The lender or holder, at its option, may provide the owner a release of lien or an endorsement and assignment of the lien to another lender refinancing the loan. Thirty days is a reasonable time for the lender to perform these duties. An affidavit of lost note, or equivalent, may be returned to the owner in lieu of the original note, if the original note has been lost. [TAC Rule §153.24].

(Q)(8) Right of Rescission

The owner and the owner's spouse have **3 calendar days** in which to rescind the extension of credit after the loan is closed. The rescission period begins at **closing** (the signing of the loan documents). Closing may occur only on or after the 12th calendar day after the later of the date that the owner makes application for the loan or the date that the owner receives the required consumer disclosure. This provision gives the owner's spouse who may not necessarily have community property ownership three calendar days to rescind the transaction. If the third calendar day falls on a Sunday or legal holiday then the right of rescission is extended to the next business day. A lender must still comply with the provisions of the Truth-in-Lending Act permitting the borrower three business days to rescind a mortgage loan in applicable transactions. If a lender complies with the right of rescission procedures in the Truth-in-Lending Act and Regulation Z, this will satisfy the requirements of complying with this section if the notices are given to all owners of the homestead and to each spouse of an owner. [TAC Rule §153.25].

(Q)(9) Acknowledgment of Fair Market Value

The owner and the lender must agree on the fair market value of the property on the date the loan is made. [TAC Rule §153.1 (9)]. A written acknowledgment will evidence that agreement. A lender may rely on the fair market value of the homestead property based on a written acknowledgment provided to the lender unless the lender has actual knowledge that the fair market value stated in the written acknowledgment is incorrect. [TX Const. Article 16 §50(h)].

(10) Lender Must Comply or Forfeit all Principal and Interest

The lender will forfeit all principal and interest if the lender fails to comply with the lender's obligations unless the lender cures the failure to comply as provided by Section 50(a)(6)(q)(x), Article xvi, of the Texas Constitution.

Equity Loan Consumer Disclosure

The **consumer disclosure** must be given at least 12 days in advance of the closing of an equity loan. A lender should establish verifiable procedures to ensure that an owner receives the required notice within the specified time frame. If a lender mails the notice to the owner, the lender must allow a reasonable period of time for delivery, i.e., a **3-day period**. A lender may supplement the notice to clarify any discrepancies or inconsistencies. [TX Const. Article 16 §50(g) and TAC Rule §153.18].

HOME EQUITY LINE OF CREDIT

A **home equity line of credit** (**HELOC**) is a form of an open-end account that may be debited from time to time, under which credit may be extended from time to time and under which the owner requests advances, repays money, and reborrows money. [TAC Rule §153.82]. An open-end loan is expandable by increments up to a maximum dollar amount. It is a line of credit that is secured by the borrower's home. The HELOC allows the homeowner to draw out cash up to a specified limit and use it at his or her discretion.

A HELOC is a type of second lien loan that taps into a property owner's equity and establishes a revolving credit line. By using the equity in their home, borrowers may qualify for a sizable amount of credit that is available for use when and how they please, at a relatively low interest rate. Furthermore, depending on each borrower's specific situation, tax laws may allow the borrower to deduct the interest because the debt is secured by the home. Both closed-end and open-end loans have a definite date by which the borrower must pay off the principal amount. Since a home is generally a consumer's largest asset, many homeowners use their home equity credit lines for major items, such as education, home improvements, or medical bills. When a HELOC is used for these purposes, it is an open-end loan. With an open-end loan, an additional amount of money may be loaned to a borrower in the future under the same security instrument.

Overview of HELOCs

A number of traditional lenders, such as banks, can offer customers a HELOC. With a home equity line, a borrower is approved for a specific **credit limit**, which is the maximum amount he or she can borrow at any one time. Many lenders set the credit limit on a home equity line by taking a percentage (75%-90%) of the appraised value of the home and subtracting the balance owed on the existing mortgage.

Example:

Appraised value of home	$100,000
Percentage of appraised value	75%
	$75,000
Less balance owed on existing mortgage	40,000
Potential credit line	$35,000

When determining the borrower's actual credit line, the lender considers the borrower's ability to repay the loan by looking at income, debts, other financial obligations, and the borrower's credit history. Home equity plans often set a fixed time during which a homeowner can borrow money (10 years, for example). When this period is up, the plan may allow the borrower to renew the credit line. With a plan that does not allow renewals, a borrower cannot borrow additional money once the time has expired.

The home equity plan outlines the method the borrower must use to repay the line of credit. Some plans may call for payment in full of any outstanding balance. Others may permit a borrower to repay over a fixed amount of time, such as 10 years.

Typically, a borrower is able to draw on the line by using special checks. Under some plans, the borrower may be limited in how he or she may use the line. Some plans require the homeowner to borrow a minimum amount each time he or she draws on the line (for example, $300) and to keep a minimum amount outstanding. Some lenders require that borrowers take an initial advance when the line is first set up.

Interest Rate Charges and Plan Features

Home equity plans typically have variable interest rates rather than fixed rates. A variable-rate HELOC is based on a published index, such as the prime rate or a U.S. Treasury bill rate. Interest rate changes coincide with the fluctuations in the chosen index. Most lenders add a margin of 1 or 2 percentage points to the index. Since the cost of borrowing is tied directly to the index rate, it is important to find out the index and margin each lender uses, how often the index changes, and how high it has risen in the past.

Sometimes lenders advertise a temporarily discounted teaser rate for home equity lines. A **teaser rate** is unusually low and often only lasts for an introductory period, such as 6 months. Variable-rate plans secured by a dwelling must have a ceiling (or lifetime cap) on the interest rate. Some variable-rate plans limit how much the payment may increase and how low the interest rate may fall if interest rates drop.

Lenders may permit a borrower to convert a variable interest rate to a fixed interest rate during the life of the plan or to convert all or a portion of the line-of-credit to a fixed-term installment loan. Agreements generally permit the lender to freeze or reduce a credit line under certain circumstances. For example, some variable-rate plans may not allow a borrower to receive additional funds during any period in which the interest rate reaches the cap.

Associated Costs

Many of the costs of setting up a home equity line of credit are similar to those borrowers pay when they buy a home.

Costs Associated with a HELOC

- A fee for a property appraisal, which estimates the value of the home
- An application fee, which may not be refundable if the borrower is turned down for credit
- Up-front charges, such as 1 “or more” point (1 point equals 1% of the credit limit)
- Other closing costs, which include fees for attorneys, title search, mortgage preparation and filing, property and title insurance, and taxes
- Certain fees during the plan. For example, some plans impose yearly membership or maintenance fees.
- Borrowers may be charged a transaction fee every time draws are made on the credit line

Repaying the HELOC

Before entering into a HELOC, a borrower should consider how he or she plans to repay the outstanding balance. Some plans set minimum payments that cover a portion of the principal (the amount borrowed) and accrued interest. Unlike a typical installment loan, the portion that goes toward principal may not be enough to repay the debt by the end of the term.

Other plans allow payments of interest only during the life of the plan, which means the borrower pays nothing toward the principal. If $10,000 is outstanding, the borrower owes the entire sum when the plan ends. If this is the case, the borrower must be prepared to make the balloon payment by refinancing with the lender, obtaining a loan from another lender, or obtaining the funds from another source.

Disclosures from Lenders

The Truth in Lending Act requires lenders to disclose the important terms and costs of their home equity plans, including the APR, miscellaneous charges, payment terms, and information about any variable-rate feature. The lender may not charge a fee until the borrower has received this information. Borrowers usually get these disclosures when they receive an application form and they receive additional disclosures before the plan is opened. If any term has changed before the plan is opened (other than a variable-rate feature), the lender must return all fees if the borrower decides not to enter into the plan as a result of the change.

Traditional Second Lien Loan vs. HELOC

A traditional second lien loan provides more predictable loan payments than a HELOC. A traditional second offers a fixed amount of money that is repayable over a fixed period. Usually, the payment schedule calls for equal payments that pay off the entire loan by the end of the loan term. A HELOC gives the borrower more flexibility while the traditional second gives the borrower a greater sense of security.

HELOC Loans on Homestead Property

An equity line of credit made on homestead property has certain requirements. [TX Const. Article 16 §50(r)]. With a home equity line of credit, the borrower may request advances, repay money, and reborrow money under the line of credit. Borrowers may not use a credit card, debit card, or similar device, preprinted check unsolicited by the borrower to obtain advances under the line of credit. However, a borrower may use a preprinted check if he or she requested preprinted checks from the lender. Each advance under the line of credit must be at least $4,000. Any fees the lender charges may be charged and collected only at the time the line of credit is established and the lender may not charge a fee in connection with any advance.

Borrowers must make regular periodic installments, not more often than every 14 days and not less often than monthly, beginning not later than two months from the date the extension of credit is established.

The maximum principal amount that may be extended, when added to all other debts secured by the home, may not exceed 80% of the fair market value of the home on the date the line of credit is established. If the principal balance under the line of credit at any time exceeds 50% of the fair market value of the home, as determined on the date the line of credit is established, borrowers may not continue to request advances under the line of credit until the balance is less than 50% of the fair market value. The lender may not unilaterally amend the terms of the line of credit. [TAC Rule §153.82-88].

REVERSE MORTGAGES

Overview of Reverse Mortgages

A reverse mortgage is a loan that is designed to enable elderly homeowners to convert the equity in their homes to monthly streams of income and/or lines of credit. A **reverse mortgage** is a non-recourse, voluntary lien, home equity loan on a homestead for homeowners aged 62 and older. [TX Const. Article 16 §50(k)(1-3)].

Using the concept of “House Rich but Cash Poor”, senior homeowners use the equity in their homes to receive cash advances and have no repayment until a future time.

A reverse mortgage is not the same as a forward mortgage—a home equity line of credit or second mortgage. A **forward mortgage** is any mortgage in which the borrower has a monthly or other periodic mortgage payment obligation. With a second mortgage, or a home equity line of credit, the homeowner must have sufficient income versus debt ratio to qualify for the loan and is required to make monthly mortgage payments.

However, in a reverse mortgage, the homeowner receives money from the lender, and generally, the homeowner does not have to pay it back as long as he or she lives in the house. [TX Const. Article 16 §50(k)(4)]. Since the homeowner receives money and makes no repayments, the debt increases and the equity decreases (unless the home appreciates). Some lenders refer to this as “rising debt, falling equity”.

A 62 year old (or older) homeowner who wants to finance a home improvement, pay off the current mortgage, supplement retirement income, or pay for healthcare expenses, might consider a reverse mortgage. It would allow the homeowner to convert part of the equity in his or her home into cash without having to sell the home or pay additional monthly bills. In this way, reverse mortgages may allow older adults to continue living in their homes and communities, with dignity, for a longer time.

The Bakers, Case Study

The Bakers—Jim (78) and Donna (77)—thought about moving after a mild stroke limited Jim's mobility. Even though they lived in a single-level Spanish style home, the stairs at both the front and back doors made it difficult for him to get in and out of their house. Additionally, the bathroom was small and only had a bathtub. They both enjoyed spending time in their backyard garden, but it was so difficult to maneuver the stairs, it was becoming a burden instead of an enjoyable pastime. However, the home was in good repair and completely paid for. They liked all their neighbors and the home was within walking distance of a grocery store, drug store, and their church.

The Bakers hoped they could continue to live in their home if they made some modifications, but they were worried about the cost. They contacted a National Association of Home Builders "Certified Aging-In-Place Specialist (CAPS)" contractor to help assess what accessibility modifications could be made to their home to assist with their current and future mobility needs. The CAPS contractor estimated that the modifications would cost approximately $30,000.

Since retiring, they had gotten along on their Social Security payments and Jim's pension. They saved some money but did not want to use it to make the modifications to their home. They thought they would need to move and started looking for a new place to live. Then they read about "reverse mortgages".

The Bakers qualified for a reverse mortgage of $120,000 and decided to take $30,000 in cash and $90,000 as a line of credit. They used $30,000 to widen the bedroom doorway, replace the bathtub with a walk-in shower, and have a ramp installed to the backyard. In addition, they could draw on the line of credit for such items as yard care and housekeeping assistance or for anything else they might need. The reverse mortgage allowed Jim and Donna to remain in their home and to live independently and comfortably.

Reverse mortgages are increasing in popularity with seniors who have equity in their homes and want to supplement retirement income. Information gathered from an AARP survey indicates that reverse mortgages are most often used to pay for daily living expenses and for unexpected medical expenses. Homeowners who have an existing mortgage also use the proceeds from a reverse mortgage to pay off the existing mortgage to eliminate monthly payments.

Reasons to Obtain a Reverse Mortgage

Example 1: Tom (82) and Mary (79) own a home valued at $375,000 with no mortgage. They both take medication daily to stay healthy. Unfortunately, the cost of medications and treatments continues to increase, which makes it difficult for them to maintain the quality of life they once enjoyed. They obtain a reverse mortgage that provides additional monthly income to cover their monthly cost for medication.

Example 2: Roger and Virginia, who are both 63 years old, own a home valued at $250,000. Although they both have pensions and will collect Social Security in a few years, they do not have enough money saved for them to spend their retirement traveling around the U.S. in their RV. Instead of getting a HELOC, they decide to get a reverse mortgage because they will not have to make monthly payments—instead, they will receive monthly payments that will be enough to supplement their pensions and pay for their travels.

Example 3: Robert (62) and Rachel (63) own a home valued at $700,000. They have no real debts, and their monthly income covers their living expenses, but they want to help pay for their grandchild's college education. Today, with the cost of college, their monthly income and savings are not sufficient. They obtain a reverse mortgage credit line. Each year they can draw money from their credit line, give their grandchild up to $26,000 (under current tax law), and not pay any federal gift tax.

Features of Reverse Mortgages

Although there are different types of reverse mortgages, all of them share certain features.

Homeownership

The homeowner retains the title to his or her home, and does not have to make monthly repayments. Because the homeowner retains title to the home, he or she is responsible for property taxes, insurance, utilities, fuel, maintenance, and other expenses. If the homeowner does not pay property taxes, carry homeowner's insurance, or maintain the condition of the home, the loan may become due and payable.

Priority Position

Most lenders require the reverse mortgage to have first priority. Advances made under a reverse mortgage and interest on those advances have priority after the reverse mortgage is recorded. [TX Const. Article 16 §50(l)]. Therefore, if the homeowner has any loans against the property, the existing loans must be paid off before applying for a reverse mortgage or must be paid off with proceeds from the reverse mortgage. Most reverse mortgage borrowers pay off any prior debt with an initial lump sum advance from their reverse mortgage.

Loan Amount

The amount that homeowners can borrow depends mostly on the specific reverse mortgage plan or program selected. It also depends on the kind of cash advances chosen. A reverse mortgage does not have a fixed loan amount or a fixed maturing date. [TX Const. Article 16 §50(n)].

Some reverse mortgages cost more than others, which reduces the amount of cash available to the homeowner. Within each loan program, the cash amounts generally depend on the borrower's age and the home's value. Generally, if the home is more valuable, the homeowner is older, and the interest rate is low, homeowners will be able to borrow more against the equity in their homes.

Loan Costs

Loan costs vary from one type of reverse mortgage to another. Not all reverse mortgages include the same types of loan costs. Therefore, the true, total cost of reverse mortgages can be difficult to compare.

That is why the federal Truth in Lending law requires lenders to disclose a total annual loan cost for reverse mortgages. [12 C.F.R. Part 226, Appendix K]. The **total annual loan cost** (TALC) is a summary of all of the costs associated with taking out a reverse mortgage, disclosed as a single annual average rate. It is a useful measure when comparing different loans. The TALC is meant to be an approximation. It considers the upfront fees, the length of time the borrower intends to live in the home, and the increase or decrease in the value of the home.

Lenders generally charge an origination fee, a mortgage insurance premium (for federally insured HECMs), and other closing costs for a reverse mortgage. Lenders also may charge servicing fees during the term of the mortgage. The lender sometimes sets these fees and costs, although origination fees for HECM reverse mortgages currently are dictated by law.

The cost of any reverse mortgage loan depends on how long the homeowner keeps the loan and how much the house appreciates. Generally, the longer a reverse mortgage is kept, the lower the total annual loan cost will be.

Homeowners can finance the loan costs (various fees charged to obtain the loan) by adding them to the loan balance. The loan costs are repaid, plus interest, when the loan is repaid.

Interest Rate

Although some reverse mortgages have fixed rates, most have variable rates that are tied to a financial index, meaning they are likely to change with market conditions. [TX Const. Article 16 §50(p)].

Advances

The advances made on a reverse mortgage loan must be made according to the terms established by the loan documents by one or more of the following five methods. [TX Const. Article 16 §50(m)].

1. Initial advance at any time and future advances at regular intervals
2. Initial advance at any time and future advances at regular intervals in which the amounts advanced may be reduced, for one or more advances, at the request of the borrower
3. Initial advance at any time and future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached
4. Initial advance at any time, future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance is repaid
5. At any time by the lender if the borrower fails to pay any of the taxes, insurance, assessments, maintenance and repair costs, or liens that have priority over the lender's lien.

With a reverse mortgage, the borrower cannot use a credit card, debit card, preprinted solicitation check, or similar device to obtain advances. After the reverse mortgage is made, the lender cannot charge the borrower a transaction fee to obtain an advance. The lender or holder may not unilaterally amend the reverse mortgage. [TX Const. Article 16 §50(v)].

Loan Balance

Although payment of principal or interest shall not be required under a reverse mortgage until the entire loan becomes due and payable, interest may accrue and be compounded during the term of the loan. Therefore, the amount owed on a reverse mortgage grows over time. Interest is charged on the outstanding balance and added to the amount owed each month. That means the total debt increases as the loan funds are advanced and interest on the loan accrues. The loan must be repaid when the last surviving borrower dies, sells the home, or no longer lives in the home as a principal residence.

Note: In the HECM program discussed later, a borrower can live in a nursing home or other medical facility for up to 12 consecutive months before the loan must be repaid.

Non-Recourse Debt Limit

The overall cap on the loan balance is called a non-recourse limit. **Non-recourse** means that the borrower (or his or her estate) will never owe more than the loan balance or the value of the property, whichever is less, and no assets other than the home must be used to repay the debt. (There is an exception for federally insured reverse mortgages, discussed later.)

Generally, the borrower cannot owe more than what his or her home is worth at the time the loan is repaid. The debt owed on a reverse mortgage equals all the loan advances received plus all the interest that is added to the loan balance. Loan advances include any advances that were used to finance loan costs or to pay off prior debt.

If the total debt is less than the value of the home when the loan is repaid, the borrower (or his or her estate) may keep the difference. However, if the loan balance grows to equal the value of the home, then the total debt is generally limited by the value of the home.

Repayment

The loan (including principal and interest) generally does not have to be repaid until the last surviving homeowner permanently moves out of the property or passes away or if the homestead property securing the loan is sold or transferred. At that time, the estate has approximately 6 months to repay the balance of the reverse mortgage or sell the home to pay off the balance. All remaining equity is inherited by the estate. The estate is not personally liable if the home sells for less than the balance of the reverse mortgage.

Default

If a homeowner defaults on the reverse mortgage, the lender can require repayment of the loan. These conditions of default are standard in any type of mortgage and include failure to pay property taxes or special assessments, failure to maintain and repair the home, or failure to keep the home insured.

Other Default Conditions

- Declaration of bankruptcy
- Abandonment of the home
- Fraud or misrepresentation
- Eminent domain or condemnation proceedings against the home

Just like a “forward mortgage”, a reverse mortgage may also include an acceleration clause that makes the loan due and payable. Typically, lenders accelerate the loan if there is a change that could affect the security of the loan. Examples include renting out part of or the entire home, adding a new owner to the home’s title, changing the zoning classification of the home, or obtaining a loan against the home. [TX Const. Article 16 §50(k)(6)].

Right of Rescission

With most reverse mortgages, the borrower has at least three business days after closing to cancel the loan for any reason, without penalty. **Business day** includes Saturdays, but not Sundays or legal public holidays.

The cancellation must be in writing—not orally by telephone or in person. To cancel, the borrower must notify the lender in writing using the form provided by the lender at closing, or by letter, fax, or telegram. It must be hand delivered, mailed, faxed, or filed with a telegraph company before midnight of the third business day.

After cancellation, the lender has 20 days to return any money that has been paid by the borrower for the financing.

Texas Rules Regarding Reverse Mortgages

In Texas, if the lender fails to make loan advances or cure the default as required in the reverse mortgage loan documents after notice from the borrower, the lender forfeits all principal and interest of the reverse mortgage.

A lender cannot begin to foreclose until the lender notifies the borrower that there is a reason to foreclose. Then, the lender must give the borrower at least 30 days to remedy the condition creating the reason for foreclosure, pay the debt secured by the homestead property, or convey the homestead property to the lender by a deed in lieu of foreclosure. Additionally, a reverse mortgage can only be secured by a lien that may be foreclosed upon only by a court order. [TX Const. Article 16 §50(k)(7-11)].

A reverse mortgage that is secured by a valid lien against homestead property may be made or acquired without regard to a limitation on the purpose and use of future advances or other mortgage proceeds or to a specific number of years or open-end advances. [TX Const. Article 16 §50(n)].

Income Tax Issues

Because reverse mortgages are considered loan advances and not income, the amount received is not taxable. Undisbursed funds under a reverse mortgage loan are considered equity in a borrower's home and not proceeds from a loan. TX Const. Article 16 §50(o)]. Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until it is paid. Usually, this occurs when the loan is repaid in full.

The interest deduction may be limited because a reverse mortgage loan generally is subject to the home equity debt limit. **Home equity debt** is a mortgage taken out after October 13, 1987, that does not qualify as home acquisition debt or as grandfathered debt and is secured by the borrower's home. The IRS limits the amount of debt that can be treated as home equity debt. The total home equity debt on a main home and second home is limited to the smaller of $100,000 ($50,000 if married filing separately) or the fair market value reduced (but not below zero) by the amount of the home acquisition debt. This is important, because any interest on amounts over the home equity debt limit generally is treated as personal interest and is not deductible.

For loans with a mortgage insurance premium, the premium is deductible on the 1040 long form.

Effect on Public Benefits

Because the payments received from a reverse mortgage are loan advances, the money does not directly affect Social Security or Medicare benefits. However, if borrowers receive Medicaid, Supplemental Security Income (SSI), or other needs-based public assistance, loan advances will be counted as liquid assets if the money is kept in a savings or checking account past the end of the calendar month in which it is received. This could make the borrower lose eligibility for the public programs if his or her total liquid assets (cash, generally) are greater than the amount allowed by those programs.

Advantages & Disadvantages of Reverse Mortgages

Advantages of Reverse Mortgages

- No taxes are paid on the cash from a reverse mortgage loan
- Social Security and Medicare benefits are not affected by reverse mortgages
- No payments are due as long as the homeowner lives in the home
- It pays off the existing mortgage on the home
- Homeowner retains title to his or her home and can sell at any time
- Homeowner continues to live in his or her home
- No pre-payment penalty with reverse mortgages
- A “non-recourse” clause, which prevents the estate from owing more than the value of the home when the loan becomes due and the home is sold.
- Heirs inherit the home and keep the remaining equity after the balance is paid off—even if the loan balance is greater than the value of the home.

Disadvantages of Reverse Mortgages

- Program is not well understood
- High upfront costs
- Equity in the home can be partially or completely used up
- Medicaid and other needs-based government assistance programs can be affected if too much money is withdrawn within a few months
- Interest on reverse mortgages is not deductible on income tax returns until the loan is paid off in part or whole

Types of Reverse Mortgages

Currently, there are three types of reverse mortgages—home equity conversion mortgages (HECM), proprietary reverse mortgages, and single-purpose reverse mortgages. Even though they share similar features, they are distinct programs.

Types of Reverse Mortgages

- Home Equity Conversion Mortgages—federally insured reverse mortgages that are backed by the U. S. Department of Housing and Urban Development.
- Proprietary Reverse Mortgages—private loans that are backed by the companies that develop them
- Public Sector Reverse Mortgages—offered by some state and local government agencies and nonprofit organizations

Many seniors choose HECMs because they are more affordable than the proprietary reverse mortgages and they offer the highest amount of money to homeowners of average-valued houses. However, if a homeowner needs help with a specific problem or needs a larger sum of money, the single-purpose reverse mortgage or the proprietary reverse mortgage may be the best choice.

Home Equity Conversion Mortgages (HECM)

The Home Equity Conversion Mortgage (HECM) is the oldest and most popular reverse mortgage product, accounting for almost all reverse mortgages made today. **Home Equity Conversion Mortgages** (HECM) are insured by the Federal Housing Administration (FHA) and are only available through an FHA approved lender.

HECM loans are widely available, have no income or medical requirements, and can be used for any purpose. HECM loans are available in all 50 states, the District of Columbia, and Puerto Rico. Currently, HECM loans may be used for traditional, purchase, or refinance transactions. [Mortgagee Letter 2010-34].

Because the HECM is insured by the FHA, both borrowers and lenders are protected. Homeowners are ensured that they will receive all payments due as long as they live in their homes. Lenders are ensured that they will receive full repayment of the loan balance, even if it is greater than the value of the property. The FHA insurance premiums that the homeowner pays as a HECM borrower create a reserve fund to cover any losses that might occur.

The FHA insurance on HECMs also protects borrowers and lenders against the risk that the loan balance might, at some time, exceed the value of the home. This means that as long as homeowners continue to occupy their property as their principal residence, they cannot be forced to sell or vacate their home—even if the loan balance exceeds the value of the home.

In addition, HECM borrowers (or their heirs or estate) will never owe more than the loan balance or the value of their property—whichever is lower. Only the home—no other assets—may be used to repay the debt, because the FHA insurance covers any further financial obligation to the lender. In addition, FHA insurance protects borrowers against the possibility of lender default. Should a lender fail to make payments to a borrower as agreed to in the loan, the FHA will continue making loan advances directly to the borrower.

Variations of HECMs

The original HECM is still the most popular type of reverse mortgage and is now called the **HECM Standard**. In 2009 and 2010, the HECM for Purchase and HECM Saver went into effect.

HECM for Purchase

The **HECM for Purchase** product allows a borrower to use a HECM to purchase a new home, rather than borrowing against a home they already own. Loan-to-value percentages are the same as for regular HECMs. The borrower can use the HECM to pay for part of the purchase, and then would have to bring a down payment equal to the remaining cost of the home.

> Example: A 62-year-old borrower who wanted to buy a $200,000 home could get about $112,000 from a HECM, and then would have to pay about $88,000, plus closing costs, using his or her own funds.

Borrowers must make their new homes their principal residence within 60 days of closing the loan. One key difference between a HECM Standard and a HECM for Purchase is that the HECM for Purchase has no rescission period.

HECM Saver

Another variation on the HECM went into effect on October 4, 2010. The **HECM Saver** product has a much lower upfront mortgage insurance premium (0.01% compared to 2%), but offers loan amounts that are 10-18% lower than the traditional HECM, which is now called the HECM Standard. This product is designed for people who want to borrow a smaller amount of money. Also, since the upfront costs are lower, it can be more appropriate for those who expect to move or sell the home within a few years.

There are no additional eligibility requirements for HECM Saver; homeowners just need to meet existing HECM program requirements. HECM Saver is available for all HECM transaction types and payment plans.

Proprietary Reverse Mortgages

A **proprietary reverse mortgage** has no government backing. Most proprietary reverse mortgages are loans offered by financial institutions that enable owners of high value homes (e.g., homes valued above $625,000) to access greater amounts of their home equity than is available from a government-insured HECM. Proprietary reverse mortgages are also known as **jumbo reverse mortgages**.

Until December 31, 2008, many lenders offered the Fannie Mae Home Keeper reverse mortgage. However, with the passage of the Housing and Economic Recovery Act (HERA), Fannie Mae discontinued the Home Keeper product. This is because HERA increased the loan limits for the Home Equity Conversion Mortgage (HECM) product and authorized HECMs for home purchases, which eliminated the need for the Home Keeper product.

Since the collapse of the housing market, all national lenders abandoned their proprietary reverse mortgage product lines because the risks (declining home values and a limited secondary market) were too great to justify offering them. Before the collapse, Lehman Brothers, which filed for bankruptcy protection in September 2008, was the world's biggest supplier of jumbo reverse mortgage funds.

Proprietary reverse mortgages nearly vanished from the marketplace during the recession. As the market recovers, some companies are offering jumbo reverse mortgages again in certain states.

> Example: In late 2010, Generation Mortgage Company re-introduced its new fixed rate jumbo proprietary reverse mortgage product—Generation Plus. Generation Plus loans are tailored specifically for seniors whose homes appraise between $500,000 and $6 million. Since the loan is not insured by the FHA, borrowers pay no mortgage insurance, but can expect to pay a higher interest rate to compensate the lender for the added risk. Borrowers are required to receive a HECM counseling certificate in order to obtain the loan and the product includes a $25 servicing fee. To qualify for a Generation Plus, a minimum FICO score of 700 is required. The credit score is critical because there is no mortgage insurance requirement. The institutional investor supplying the funds for the loan wants assurance that the property owner has the ability to maintain the property and pay taxes and insurance. Instead of payment plans, the funds are taken at closing.

Just like HECM loans, there are no limits on how the borrower uses the funds. The only restriction is that the borrower must pay off any liens against the home.

Public Sector Reverse Mortgages

Many local and some state government agencies offer reverse mortgages for repairing or improving homes or paying property taxes. Typically, public sector reverse mortgages provide a one-time, lump sum advance and no repayment is required for as long as the homeowner lives in his or her home.

These reverse mortgages are also known as **single purpose reverse mortgages**. Single purpose means exactly that. The proceeds may be used for only the purpose specified by the government agency or nonprofit lender. Often, the programs are designed for homeowners with low or moderate income. Single-purpose reverse mortgages generally have very low costs.

Two common public sector reverse mortgages are deferred payment loans and property tax deferral loans.

Deferred Payment Loans

A **deferred payment loan** (DPL) is a loan offered by some state and local government agencies for repairing or improving homes. DPLs are not available from every state or local government agency; and when available, they go by a variety of names and descriptions.

Eligibility criteria vary from program to program. Most are limited to homeowners with low or moderate incomes. Many place a limit on a home's value, or lend only in defined areas. Some have a minimum borrower age or a disability requirement.

Typically, DPLs can be used only for the specific types of repairs or improvements that each program allows. This may limit the homeowner to projects that replace or repair basic items, such as the roof, wiring, heating, plumbing, floors, stairs, or porches. Many programs will cover improvements for accessibility or energy efficiency. Such modifications may include the installation of ramps, rails, grab bars, storm windows, insulation, or weather-stripping.

The best thing about DPLs is their very low cost. Generally, they have no origination fee, no insurance premium, minimal (if any) closing costs, and very low (or no) interest. If interest is charged, it is often done on a fixed basis. Many DPL programs also charge simple rather than compound interest. Some DPL programs even forgive part or the entire loan if the homeowner lives in his or her home for a specific period of time.

Property Tax Deferral Loans

Some state and local government agencies offer **property tax deferral** (PTD) loans. This type of public sector reverse mortgage generally provides annual loan advances that can be used only to pay property taxes. No repayment is required for as long as the homeowner lives in the home.

Eligibility criteria vary considerably among jurisdictions. Most programs have a minimum age of 65 and are limited to homeowners with low or moderate incomes. The amount of the annual PTD loan advance is usually limited to the amount of the property tax bill for that year. Like deferred payment loans, PTD loans generally charge no origination fee, no insurance premium, and minimal, if any, closing costs. The interest rate is usually fixed, but it varies from program to program.

PTD programs typically do not permit these loans to be subordinate to other loans. Therefore, a homeowner cannot have a PTD loan and another reverse mortgage at the same time.

FHA HOME EQUITY CONVERSION PROGRAM

All FHA-approved lenders are eligible to participate in the HECM program. The FHA insurance feature benefits the borrowers because if the lender is unable to make payments to the borrower, HUD will make payments for the remainder of the mortgage.

Eligibility Requirements

The FHA has eligibility requirements for both the borrowers and their properties. If eligibility requirements are met, the Mortgage Credit Branch will issue a Firm Commitment with a term of 90 days or the remainder of the Conditional Commitment, whichever is longer.

In addition, each borrower must receive mandatory counseling regarding the HECM from a HUD-approved counseling agency. Texas law requires that the owner of the homestead attests in writing that the owner received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives. [TX Const. Article 16 §50(k)(8)].

Borrower Eligibility Requirements

To be eligible for a HECM loan, the Federal Housing Administration (FHA) has eligibility requirements regarding the borrower’s age, the borrower’s occupancy of the property as the principal residence, and the borrower’s federal credit record.

Borrower's Age. All borrowers must be at least 62 years old when they sign the application. Borrowers must provide the lender with evidence of their age—typically with a photo I.D. Identification may be a photocopy of the driver's license, passport, job or trade union identification card, or similar official documentation. Additionally, a borrower must give the lender his or her Social Security number. The actual Social Security card is not required if the Social Security number can be obtained from another source, such as a driver's license, pay stub or bank statement.

Borrower's Principal Residence. The property must be the principal residence of each borrower. Married spouses or other co-borrowers may be living apart because one of them is temporarily or permanently in a health care facility; however, at least one borrower must be living in the home in order for the HECM loan to close. The home must be owned free and clear. However, if there is a mortgage balance, it can be paid off completely with the proceeds of the reverse mortgage loan at closing.

Borrower's Federal Credit Record. The borrower cannot have a delinquent or defaulted federal debt that cannot be satisfied at closing. Payment of an insurance claim by HUD on a previously insured mortgage does not automatically preclude the borrower from qualifying for a reverse mortgage if valid extenuating circumstances caused the foreclosure.

Federal Credit Eligibility Requirements

Generally, there are no income, employment, or credit score requirements for a reverse mortgage. However, the lender will obtain the borrower's credit report to check for any claims or defaults on debts owed to the federal government, and any existing debts on the property.

Generally unsecured debts other than delinquent federal debts, regardless of their status (e.g., delinquent credit card accounts), do not impact negatively on the borrower's eligibility. However, a borrower's application will be rejected if he or she is delinquent on a federal debt or is excluded from federal procurement programs.

Delinquent Federal Debts. A borrower who is delinquent on any federal debt or has a lien placed against his or her property for a debt owed to the United States is not eligible for a HECM until the delinquent account is brought current, paid, or otherwise satisfied (e.g., a verifiable repayment plan between the borrower and the federal agency owed). Federal debts include items such as VA-guaranteed mortgages, HUD Section 312 Rehabilitation loans, Title I loans, federal student loans, Small Business Administration loans, and delinquent federal taxes.

Suspensions and Debarments from Federal Lists. The application is not eligible for mortgage insurance if a borrower's name appears on HUD's "Limited Denial of Participation (LDP) List" or the General Services Administration's (GSA's) "List of Parties Excluded from Federal Procurement or Nonprocurement Programs."

Screening by the Credit Alert Interactive Voice Response System. All borrowers are screened using the Credit Alert Interactive Voice Response System (CAIVRS). A borrower is ineligible if CAIVRS indicates that the borrower is delinquent or has had a claim paid within the previous 3 years on a loan made or insured by HUD.

There are three exceptions to the delinquent federal debt policy:

1. **Assumptions**. If the borrower sold the property, with or without a release of liability, to a mortgagor who subsequently defaulted, and it can be proven that the loan was current at the time of assumption, the borrower is eligible.
2. **Divorce**. A borrower may be eligible if the divorce decree or legal separation agreement awarded the property and responsibility for payment to the former spouse. However, if a claim was paid on a mortgage in default at the time of the divorce, the borrower is not eligible.
3. **Bankruptcy**. If the property was included in a bankruptcy that was caused by circumstances beyond the borrower's control (e.g., death of the principal wage earner, loss of employment due to company closing, or serious long-term uninsured illness), the borrower may be eligible.

Property Eligibility Requirements

Almost all home types are eligible, but homes must meet all FHA property standards and flood requirements. The ownership interest in an eligible property must be held in fee simple, or under a lease for not less than 99 years that is renewable, or under a lease having a remaining term of not less than 50 years beyond the 100th birthday of the youngest borrower.

Eligible Properties

- Existing, one unit properties
- Condominium units in a HUD-approved condominium project
- Units in a HUD-approved planned unit development (PUD)
- Properties located in an area designated by the Federal Emergency Management Agency (FEMA) as a flood plain area having special flood hazards are eligible, providing appropriate flood insurance is maintained and the community in which the area is situated is participating in the National Flood Insurance Program.
- Manufactured homes that meet the following requirements:
  1) The home must have a floor area of no less than 400 square feet.
  2) The home must be built after June 15, 1976 and constructed in conformance with Federal Manufactured Home Construction and Safety Standards, as evidenced by an affixed certification label.
  3) The home must be classified and taxed as real estate.
  4) The home must not have been occupied or installed at another site.

Ineligible Properties

- Two-, three-, and four-unit properties
- Units in a cooperative housing development
- Manufactured homes produced prior to June 15, 1976
- Properties located in HUD's Special Risk Insurance Fund areas

Required Repairs

Properties that need repairs to meet the minimum acceptable level of quality for existing properties may still be eligible. HUD requires that properties meet the Requirements for Existing Housing in Handbook 4905.1. Any repairs desired by the borrower that are not required by HUD are not a condition for the approval of the mortgage. Additionally, lenders cannot require borrowers to make repairs that are not required to meet minimum property standards.

Required repairs that are estimated to cost more than 15% of the maximum claim amount must be completed before closing.

Any required repairs that are estimated to cost less than 15% of the maximum claim amount can be completed after closing. Money to pay for required repairs will not be held back in an escrow account.

Property Appraisal

The financial soundness of the HECM program requires an accurate determination of property value and property condition. Therefore, most properties are appraised as part of the HECM program. The appraisal must be completed on the URAR in accordance with current HUD Valuation policy. Sometimes, the local HUD office allows appraisals performed for Section 203(b) and 234(c) mortgages to be used for HECMs. However, a Certificate of Reasonable Value from the Department of Veterans Affairs (VA-CRV) cannot be substituted for an FHA appraisal.

Requirement for Mandatory HECM Counseling

When a lender receives a request from a borrower to apply for a HECM, the lender refers the borrower to a HUD-approved counseling agency in the area. Prospective borrowers must discuss the HECM with a counselor from a HUD-approved counseling agency before the HECM application is processed. HUD certifies counselors around the country to give seniors an unprejudiced education about reverse mortgages. Counseling can be done over the phone with a national agency or face-to-face with a local agency. Counseling, on average, costs about $125. Lenders are not permitted to pay this fee for the homeowners but are allowed to reimburse them at closing.

HECM counselors must discuss the financial implications of entering into a home equity conversion mortgage and that a HECM may have consequences for the borrower's taxes, estate, and eligibility for assistance under federal and state programs. HECM counselors explain the loan's costs and financial implications, as well as possible alternatives to a HECM, like government and nonprofit programs or a single-purpose or proprietary reverse mortgage. Counselors also should be able to compare the costs of different types of reverse mortgages and tell the borrower how different payment options, fees, and other costs affect the total cost of the loan over time.

Upon completion of the counseling, the agency gives a HECM Certificate of Borrower Counseling to the borrower. The borrower gives this certificate to the lender who submits it to HUD as part of the lender's application for mortgage insurance. Until the lender receives the HECM Certificate of Borrower Counseling from the borrower, the lender cannot submit the application, begin the process of ordering a property appraisal, or do any other action that would result in a charge to the potential borrower. The lender may complete the borrower's application before referral, however, the lender cannot charge the borrower for this service if the borrower does not choose to attend a counseling session or apply for a HECM after counseling.

Example: Bob is 69 and owns a huge 8-bedroom, 5-bathroom house that is valued at $920,000. Bob's home requires an extraordinary amount of maintenance, which is not only time consuming, but is also quite expensive. Bob is considering getting a reverse mortgage for $60,000 to pay for some home renovations and repairs. Is this his best option? A HECM counselor would help Bob look at a variety of options. Bob could select a reverse mortgage, sell the huge house and downsize to a smaller home that he can manage by himself, or even rent the additional bedrooms to provide some extra income.

CERTIFICATE OF BORROWER COUNSELING

For:____

Name(s) of Borrower(s)

In order to obtain a Home Equity Conversion Mortgage insured by the Department of Housing and Urban Development (HUD), the borrower(s) is/are required by law to receive counseling by a HUD-approved counseling agency.

The counselor must discuss the following items with the borrower(s):

1. Options other than a Home Equity Conversion Mortgage that are available to the borrower(s), including other housing, social service, health, and financial options.
2. Other home equity conversion options that are or may become available to the borrower(s), such as sale-leaseback financing, deferred payment loans, and property tax deferral.
3. The financial implications of entering into a Home Equity Conversion Mortgage.
4. A disclosure that a Home Equity Conversion Mortgage may have tax consequences, effect eligibility for assistance under federal and state programs, and have an impact on the estate and heirs of the borrower(s).

I certify that the borrower(s) listed above have received counseling according to the requirements of this certificate.

_________________________ _______________________ __________

Agency Official Date

I certify that I have received counseling according to the requirements of this certificate.

____ __________

Borrower Date

____ __________

Borrower Date

Amount of the Loan (Principal Limit)

The payments that a homeowner can receive from a HECM are determined by calculating the principal limit. The **principal limit** is the present value of the loan proceeds available to the borrower. It is determined at closing. Then it increases each month by 1/12 of the sum of the expected rate and the annual mortgage insurance premium (MIP) rate.

The principal limit depends on several factors, including the age of the youngest borrower, the expected average mortgage interest rate, the maximum claim amount, and the initial mortgage insurance premium option chosen (2% HECM Standard option or .01% HECM Saver option).

Except in limited circumstances, the borrower will be unable to receive additional payments once the outstanding balance equals the principal limit.

Age of the Youngest Borrower

In the case of couples or joint owners, the age of the youngest borrower is a consideration. A longer life expectancy would result in more monthly advances, and therefore more costs (servicing fees, mortgage insurance premiums, and interest) added to the loan balance.

Expected Average Mortgage Interest Rate

The expected average mortgage interest rate (**expected rate**) is fixed throughout the life of the loan and is used to determine payments to the borrower. HECM borrowers can choose an adjustable interest rate or a fixed rate. For a fixed rate loan, the expected rate is the fixed interest rate. For an adjustable rate loan, the expected rate is the sum of the lender's margin and the U.S. Treasury Securities rate adjusted to a constant maturity of ten years.

Maximum Claim Amount

With a HECM, the maximum claim amount is used to determine the total amount of equity a homeowner can borrow from his or her home. The maximum claim amount is the lesser of the appraised value of the property or the maximum mortgage amount for a one-family residence that HUD will insure in an area under Section 203(b)(2) of the National Housing Act.

The maximum claim amount is established when the Conditional Commitment is issued and represents the maximum amount that HUD will pay on a claim for insurance benefits.

The principal limit is calculated by multiplying the Maximum Claim Amount by a factor supplied by the Secretary. [Mortgagee Letter 2010-34].

HECM Standard or HECM Saver Option

Since the HECM loan is FHA-insured, borrowers pay an initial mortgage insurance premium (MIP), which is based on the maximum claim amount and collected at the time of closing. The initial MIP is 2% (0.02) for the HECM Standard and is 0.01% (0.0001) for the HECM Saver option.

The HECM Saver differs from the traditional HECM Standard Program because eligible borrowers 62 years and older will be charged significantly lower upfront fees. However, the lower upfront fees result in less money being made available to the borrower than is available under HECM Standard.

Payment Plans

Under the FHA HECM, a borrower has the choice of receiving the mortgage proceeds through five basic payment plans—tenure, term, line of credit, modified tenure, and modified term. The borrower may choose any of these provided it meets the requirements described in Section 50(p) of the Texas Constitution.

Types of Payment Plans

Tenure. The borrower will receive equal monthly payments from the lender as long as at least one borrower lives and continues to occupy the property as a principal residence.

Term. The borrower will receive equal monthly payments from the lender for a fixed period of months selected by the borrower.

Line of Credit. The borrower will receive the mortgage proceeds in unscheduled payments or installments, at times and in amounts of the borrower's choosing, until the line of credit is exhausted.

Modified Tenure. The borrower may combine a line of credit with monthly payments for life, or for as long as the borrower continues to live in the home as a principal residence. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted.

Modified Term. The borrower may combine a line of credit with monthly payments for a fixed period of months selected by the borrower. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted.

A borrower may choose any payment plan, as long as the payments plus accrued interest, monthly MIP, and funds set aside, if any, do not exceed the principal limit. A borrower may receive a cash advance, provided the outstanding balance does not exceed the principal limit.

A borrower can change the type of payment plan throughout the life of the loan. For example, the borrower may change the term of payments, may receive an unscheduled payment, may suspend payments, may establish or terminate a line of credit, or may receive the entire net principal limit in a lump sum payment. The **net principal limit** is the difference between the current principal limit and the outstanding balance.

When the outstanding balance equals the principal limit, the borrower cannot receive any more payments, but may remain in the property as long as he or she desires.

Interest Rate

Interest will accrue at a fixed or adjustable rate, as negotiated between the borrower and the lender. Interest is accrued daily and is added to the outstanding balance monthly.

The borrower will not be able to change from a fixed to an adjustable rate or vice versa after closing. Lenders may not adjust annually adjusted HECMs by more than 2 percentage points per year and not by more than 5 total percentage points over the life of the loan. The FHA does not require interest rate caps on monthly-adjusted HECMs.

Obviously, the lower the interest rate on the loan, the lower its cost, and the more total funds available for borrowing. Similarly, the higher the rate, the higher the cost of the loan, and the less funds available for borrowing.

HECM Costs

HECMs may be more expensive than traditional home loans, and the upfront costs can be high. This is an important consideration, especially if the borrower plans to stay in the home for just a short time or only borrow a small amount.

The basic charges (other than interest) on a HECM include an origination fee, initial and monthly mortgage insurance premiums, other closing costs, and a monthly servicing fee. Lenders are not permitted to charge discount points. Borrowers do not have to pay closing costs in cash at closing. With the exception of the origination fee, borrowers are allowed to finance 100% of the closing costs by adding them to the outstanding balance. However, lenders may require borrowers to pay for services performed by third parties related to the processing of the borrower's application (e.g., credit report, appraisal, title commitment, etc.). The borrower may request to be reimbursed for these expenses at closing, and have these costs added to the outstanding balance on the mortgage.

All HECM lenders must follow HUD rules. Even though the mortgage insurance premium is the same from lender to lender, most loan costs, including the origination fee, closing costs, and servicing fees, vary among lenders.

Origination Fee

Lenders may charge an origination fee to cover expenses incurred in processing and underwriting the borrower's loan. A lender can charge a HECM origination fee up to $2,500 if the home is valued at less than $125,000. If the home is valued at more than $125,000, lenders can charge 2% of the first $200,000 of the home's value plus 1% of the amount over $200,000. HECM origination fees are capped at $6,000.

The borrower is not permitted to pay any additional origination fees of any kind to a mortgage broker or loan correspondent.

Some lenders are waiving or reducing origination fees on many of their loans. However, lenders may offer a lower origination fee in exchange for a higher interest rate.

Mortgage Insurance Premium (MIP)

The borrower will be charged mortgage insurance premiums (MIP) to reduce the risk of loss in the event that the outstanding balance (including accrued interest, MIP, and fees) exceeds the value of the property at the time that the mortgage is due and payable.

HECM borrowers are charged for an initial mortgage insurance premium, as well as an annual mortgage insurance premium. As stated previously, the initial MIP is 2 percent (0.02) of the maximum claim amount for HECM Standard and .01 percent (0.0001) for the HECM Saver. [Mortgagee Letter 2010-34]. In addition, the MIP for both HECM Standard and HECM Saver will be charged monthly at an annual rate of 1.25% (0.0125) of the outstanding loan balance. The MIP will be added to the outstanding balance and remitted to HUD monthly by the lender.

Other Closing Costs

Other closing costs cover any services and charges—such as title search and insurance, appraisals, surveys, credit histories, required inspections, taxes, and recording fees—that are necessary to complete the transaction. These closing costs vary from one locality to another. Borrowers may finance 100% of the closing costs. If a lender requires a borrower to pay for property appraisals, inspections, or other services performed by third parties, the lender can reimburse the borrower for these costs at closing and can add them to the loan balance.

If the origination fee, initial mortgage insurance premium, and other closing costs are financed, the principal limit (the total amount of funds available for borrowing) will be reduced. Additionally, interest charges will be incurred on these financed closing costs.

Typical Closing Costs

- Appraisal
- Credit report
- Title insurance
- Document preparation
- Recording fees
- Endorsement
- Escrow/settlement fee
- Termite inspection
- Flood zone certification
- Attorney's fees & title exam
- Intangible tax (paid to county)

Servicing Fee

Lenders or their agents provide servicing throughout the life of the HECM. **Servicing** includes sending account statements, disbursing loan proceeds and making certain that the borrower keeps up with loan requirements, such as paying taxes and insurance.

HECM lenders may charge borrowers a monthly servicing fee if this cost has not already been priced into the borrower's mortgage interest rate. The servicing fee may not exceed $30 if the loan has an annually adjusting interest rate or $35 if the interest rate adjusts monthly. The lender adds this fee to the borrower's outstanding balance monthly, and cannot assess any other fees to cover the costs of servicing.

As with origination fees, some lenders are reducing or eliminating monthly servicing fees on many loans. However, the lower service fees may be offset by higher interest rates in some cases.

Repaying the HECM

Unlike ordinary home equity loans, a HECM does not require repayment as long as the home is the borrower's principal residence and the obligations of the mortgage are met. However, a borrower may make partial prepayments during the term of the loan.

Partial Prepayment

A borrower may prepay all or part of the outstanding balance at any time without penalty. Borrowers may partially prepay the loan to preserve equity in the property, to increase monthly payments, or to increase the line of credit. When a borrower makes a partial prepayment, it reduces the outstanding balance and increases the net principal limit available for calculating monthly payments or increases the amount available in a line of credit.

If a borrower repays the entire outstanding balance in order to refinance the mortgage, the loan agreement is terminated. If the new mortgage is a HECM, the borrower will have to pay a new initial MIP and meet other eligibility criteria.

Recovery of Mortgage Proceeds

Lenders recover their principal, plus interest, when the mortgage becomes due and payable, which is known as a **maturity event**. A mortgage will become due and payable when the last remaining borrower dies, the property ceases to be the borrower's principal residence, the borrower does not occupy the property for 12 consecutive months for health reasons, or the borrower violates the terms of the mortgage or note. At the maturity event, the property will normally be sold by the borrower or the borrower's estate to pay off the outstanding balance on the mortgage. The remaining equity in the home, if any, belongs to the borrower or to his or her heirs.

Since a HECM is a non-recourse loan, the lender's recovery from the borrower will be limited to the value of the home. There will be no deficiency judgment taken against the borrower or the estate because there is no personal liability for payment of the loan balance. If the sales proceeds are insufficient to pay off the outstanding balance, the lender will file a claim with the FHA for the difference between the proceeds from the sale of the property and the outstanding balance, up to the maximum claim amount. The FHA will pay the lender the amount of the shortfall.

FORECLOSURES ON HOMESTEAD PROPERTY

When a property owner becomes delinquent in payments and all preliminary efforts at collection have been fruitless, the final remedy is foreclosure. **Foreclosure** is the legal procedure used by lenders to terminate all rights, title, and interest of the trustor or mortgagor in real property by selling the property and using the sale proceeds to satisfy the liens of creditors. Texas is known as a title theory state where the property title remains in trust until payment in full occurs for the underlying loan.

Rules of Foreclosure

Rules governing foreclosure of equity loans, reverse mortgages, and home equity lines of credit originate from three sources—the promissory note and security instrument, and pertinent Texas statutory law (Texas Rules of Civil Procedure 735 & 736, and Chapter 51 of the Texas Property Code).

By signing the promissory note, the borrower pledges to pay the amount of the note according to the stated terms and provisions. This instrument continues the borrower's personal liability to repay the balance of the note when the foreclosure sale generates insufficient revenue.

By signing the security instrument (typically a deed of trust), the borrower grants the lender a security interest in the property being purchased or pledged as security (collateral) for the loan. The deed of trust gives the trustee the authority to sell the collateral when a default occurs. The trustee conducts the foreclosure sale and conveys title to the highest bidder.

Relevant statutory law provides the third source—the key statutes being the Texas Rules of Civil Procedure 735 & 736 and Chapter 51 of the Texas Property Code.

Foreclosure Process

There are two ways to foreclose—non-judicial foreclosure or judicial foreclosure. Most residential mortgage foreclosures in Texas are non-judicial, which means the lender can foreclose without going to court so long as the deed of trust contains a power of sale clause. A **power of sale clause** is a paragraph in the mortgage that authorizes the non-judicial foreclosure sale. If there is no power of sale clause then a judicial foreclosure process is used.

However, if the mortgage is a home equity loan, reverse mortgage, or home equity line of credit then the lender (or person seeking to foreclose a lien) must obtain a **court order** (judgment for judicial foreclosure or an expedited order) pursuant to the Texas Rules of Civil Procedure 735 and 736 before actually proceeding with the foreclosure. The expedited order is used to foreclose deeds of trust with a non-judicial foreclosure.

Obtaining an Expedited Order to Foreclose

Foreclosure of a deed of trust for a home equity, home equity line of credit and reverse mortgage loan requires a Rule 736 court order (also called an **expedited order**). An application for an expedited order can be filed in any court (including probate courts) with appropriate jurisdiction in the county where all or part of the real property being foreclosed is located.

Notice to Borrowers

The lender or mortgage servicer must give the borrower notice and the opportunity to cure the default. For a home equity or home equity line of credit loan, the borrower must be given 20 days to cure the default and for a reverse mortgage the borrower must be given up to 30 days. [TX Const. Art XVI [§51.002(b) and §50(k)(10)].

Contents of the Notice to Borrowers

- The parties to an expedited order application must be identified by name and their last known address.
- Each Expedited Order Application must have the commonly known street address and legal description of the property to be foreclosed. The street address should be the same as the mailing address.
- The type of lien being foreclosed (home equity, reverse mortgage, or home equity line of credit) must be indicated.

- The authority of the party seeking foreclosure, whether as the servicer, beneficiary, lender, investor, or other person with authority to prosecute the foreclosure must be stated.
- The name of each person obligated to pay the lien being foreclosed must be stated.
- The amount to cure the default, the number of scheduled payments that have not been made, and the payoff amount must be calculated within 60 days before the application is filed.
- Proof that the requisite notice (s) to cure the default has (have) been mailed to each person as required under applicable law and that the opportunity to cure has expired.
- To ensure that a borrower is aware that an expedited order could result in a foreclosure of the secured property, the application must contain a conspicuous disclosure that:

  (a) Legal action is not being sought against the occupant of the property unless the Occupant is also named as a borrower in the application.
  (b) If the lender obtains a court order, the lender will proceed with a foreclosure of the property in accordance with applicable law and the terms of the lien being foreclosed.

The lender or its servicer must present the material facts describing the basis of the foreclosure in the expedited order application and attach a legible copy of the note, original recorded lien, and current assignment of the lien, if assigned. Additionally, all notices and other documents necessary to initiate foreclosure must be attached to the expedited order application.

Citation: Service, and Return

When the expedited order application is filed, the clerk of the court serves the citation (instead of the lender's attorney) by both certified and regular mail. The date of service is the date the clerk puts the citation into the custody of the U.S. Postal Service. Since service and return are done concurrently, the date of service and return are the same date. The mailing address for all citations is the last known address for each borrower and the property street address as shown in the application.

Borrower's Response to the Application

No discovery is permitted under an expedited order application. If a borrower wishes to obtain discovery to contest some aspect of the foreclosure process, the borrower must file a normal lawsuit.

However, a borrower may file a response to the application. The latest date for any response is the first Monday after the expiration of 38 days from the date the clerk served the citation. The date of mailing must be stated in each citation because the response date is calculated from the date of service.

Statements a Borrower May Include in the Response

- Statement why the borrower believes that he or she did not sign the loan agreement document.
- Statement why the borrower is not obligated for payment of the lien.

- Statement why the number of months the loan is alleged to have been in default, or the reinstatement or payoff amount alleged in the application, are materially incorrect.
- Statement why a document attached to the application is not a true and correct copy of the original.
- Proof of payment as required under TX Rules of Civil Procedure §95, which states "the borrower must file an accounting that states distinctly the nature of payment and when payments were made."

If a borrower files a response, the court must hold a hearing "after reasonable notice to the parties."

However, if no response is filed, the lender prepares and files a motion for default and order for review by the presiding judge. The court must sign a Rule 736 default order within 30 days of receipt of the motion and order so long as the application contains all the elements required by Rule 736.1 and the citation was properly served in accordance with Rule 736.4.

Issuance of Court Order

The court must issue an order granting the application if the lender establishes the basis for the foreclosure. Otherwise, the court must deny the application. Certain items must be included in the court order granting an expedited order application.

Items Required in the Court Order

- A description of the material facts establishing the basis for foreclosure,
- The commonly known mailing address and legal description of the property being foreclosed,
- The name and last known address of each borrower, and
- The real property recording or indexing information of the lien being foreclosed.

Effect of the Court Order

Once a Rule 736 order (expedited order) is obtained, the lender may continue with the normal foreclosure process required by applicable law and the terms of the instrument creating the lien being foreclosed.

Automatic Stay - Filing Bankruptcy or an Independent Lawsuit

If the borrower files bankruptcy before a Rule 736 order is entered, the 736 proceeding is stopped so long as the automatic stay in the bankruptcy proceeding is in effect. Once the stay is lifted, the lender can proceed to obtain an expedited order. The borrower must provide the clerk of the court with proof that bankruptcy was filed before the order is entered.

If the borrower files a separate, original proceeding in a court of competent jurisdiction that puts at issue any matter related to the origination of the loan agreement, contract or lien being foreclosed prior to 5:00 p.m. on the Monday before the scheduled foreclosure sale, a Rule 736 proceeding or order is stopped. The automatic stay applies whether the application is pending or a Rule 736 order has been entered but the property has not been foreclosed.

Requirement to Attach Order to Trustee's Deed

In order to record title and to confirm that a court order was actually obtained, a copy of the applicable expedited order must be attached to the trustee's foreclosure deed.

Non-Judicial Foreclosure

Most residential mortgage foreclosures in Texas are non-judicial, which means the lender can foreclose without going to court so long as the deed of trust contains a power of sale clause. (A power of sale clause is a paragraph in the security instrument (deed of trust or mortgage) that authorizes the non-judicial foreclosure sale. If there is no power of sale clause then a judicial foreclosure process is used.

Notice of Default

Texas law requires the lender/servicer to send a **notice of default** (often called breach or demand letter) informing a borrower that his or her loan is in default. The lender must give the borrower at least 20 days' notice to cure the default. The notice is sent to the borrower's last known address and must include the amount due and the date it must be paid.

The notice of default must specify:

- the default,
- the action required to cure the default,
- a date (usually not less than 30 days from the date the notice is given to the borrower) by which the default must be cured, and
- that failure to cure the default on or before the date specified in the notice may result in acceleration of the debt and sale of the property.

During the 20 days before accelerating the loan, the borrower still can prevent the foreclosure sale by **reinstating** (bringing current) the loan.

If the borrower does not cure the default, the lender notifies the borrower that the loan will be accelerated and the property will be sold to pay the loan. The **acceleration clause** in the deed of trust permits the lender to demand that the entire balance of the loan be repaid if the borrower defaults on the loan. Without the acceleration clause, the lender would be forced into a series of foreclosures, foreclosing only on the amount of the installment in default and not the entire unpaid balance of the note. After accelerating the note, the lender requests that the trustee sells the property.

Notice of Sale

The trustee must strictly comply with Section 51.002 of the Texas Property Code and any other requirements set forth both in the deed of trust to ensure a valid foreclosure sale. The purpose of the notice is to alert the borrower and prospective purchasers of the sale.

The notice should contain the date of the deed of trust along with the volume and page where it is recorded; the name of lender, borrower, and trustee; a statement of default and a request for the trustee to the sell property; and the time, date, terms and place of sale. Additionally, the notice of sale must include a disclosure geared toward military service members that they should notify the sender of the notice about their military status.

After the cure period has expired, and at least 21 days before the foreclosure sale, the trustee then sends a notice of sale (via certified mail) to each borrower who is obligated to pay the debt. The notice of sale will also be posted at the courthouse door in the county in which the property is located and filed with the county clerk in the county in which the property is located.

The county clerk does not file the notice in the deed records. Instead, the county clerk is required to keep all such notices in a file conveniently available to the public for examination during normal business hours and until after the date of the sale specified in the notice.

The Foreclosure Sale

Foreclosure sales are held the first Tuesday of each month between 10:00 a.m. and 4:00 p.m. at the county courthouse. The sale must begin at the time stated in the notice of sale, but no later than 3 hours after the time scheduled on the notice of sale.

The sale must take place even if the first Tuesday of the month falls on a holiday. If the trustee fails to conduct the sale on the designated date, the entire process of sending, posting and filing notices must be repeated.

The trustee has the sole authority to sell the collateral and to convey title. The debtor grants this authority to the trustee in the deed of trust. The trustee's sole duty is to conduct the sale in a prescribed manner to reduce the loan as much as possible by securing a fair price. The trustee begins the sale by reading a copy of the posted notice and stating the terms of the sale. Generally, the trustee requires cash-only sales. The bid price is payable immediately on acceptance by the trustee. All parties present may bid, including the lender and the borrower.

The trustee sells the property to the highest bidder and conveys the property by way of a trustee's deed. Any purchaser acquires the property "as is" without any express or implied warranties of title.

A borrower has no right of redemption after the foreclosure sale. A **right of redemption** is the right of a borrower to regain ownership of property after foreclosure by paying the amount that the property was sold for at the foreclosure sale.

Division of Proceeds

Once the sale concludes, the trustee divides the proceeds.

Proceeds from the sale of the property are paid out in the following order.

1. Trustee's fees, costs, and expenses relating to the sale
2. Unpaid principal, interest, late fees, and other unpaid charges as provided in the real estate lien note
3. Junior lienholders in their order of priority
4. The remaining balance to the defaulting borrower

Deficiency Judgment Following Sale

Sometimes the proceeds of the sale are not sufficient to satisfy the trustee's fees, expenses of the sale, and the debt being foreclosed. If that happens, the lender may try to obtain a deficiency judgment against the borrower. A **deficiency judgment** is a personal judgment against a borrower for the difference between the unpaid amount of the loan, plus interest, costs and fees of the sale, and the amount of the actual proceeds of the foreclosure sale. This means if the property sells for less than what is owed to the lender, the borrower will be personally responsible for repayment after the deficiency judgment is filed.

> Example: The total debt owed is $200,000, but the home only sells for $150,000 at the foreclosure sale. The deficiency is $50,000.

Texas allows deficiency judgments but has limits to protect homeowners. Currently the deficiency judgment is limited to the difference between the fair market value of the foreclosed property (regardless of what the property sold for at the foreclosure sale) and the defaulted loan amount at the time of sale. Fair market value is determined by appraisal. For non-judicial Texas foreclosures, the lender must file a lawsuit to obtain the deficiency judgment within two years after the foreclosure sale.

> **NOTE**: Texas law does NOT ALLOW deficiency judgments following the foreclosure of a home equity loan because loans made against homestead property are made without recourse for personal liability against owners and their spouses, unless the loan was obtained by actual fraud. [TX Const. Art. XVI, §50[a][6][C)].

Redemption Period

Texas has no statutory right of redemption after the foreclosure. A **redemption period** is the legal right of a mortgage borrower in foreclosure to pay off the total debt, including the principal balance, plus certain additional costs and interest, in order to reclaim the property. Once a home has been foreclosed, it cannot be redeemed.

Eviction Following Foreclosure

If the defaulting homeowner does not voluntarily vacate the property following the foreclosure sale, the new owner may offer "cash-for-keys" or will start an eviction process.

With cash-for-keys, the new owner offers money in exchange for an agreement to move. This is generally cheaper and faster for the new owner than going to court for an eviction.

The eviction process begins when the new owner serves the former owner with a 3-day notice to quit (leave) and then files an eviction (forcible detainer) lawsuit. After the court grants judgment, it can issue a writ of possession after the expiration of five days. The sheriff then posts a 24-hour warning at the property. If the occupants do not vacate the property, the sheriff enters the property and removes the occupants and their belongings.

Summary of Texas' Non-judicial Foreclosure	
Most common foreclosure	Non-judicial under power of sale in deed of trust
Time to respond	Foreclosing party must serve notice of default 20 days before serving notice of sale. Notice of sale must be served by mail on homeowner 21 days before sale. Foreclosing party must also post notice of sale on courthouse door (or wherever court commissioners determine is equivalent).
Reinstatement of loan	Available within 20 days after service of notice of default
Redemption after sale	Not available
Deficiency judgments	NOT allowed on home equity loans, reverse mortgages, or HELOCs. Allowed if foreclosing party brings separate lawsuit within 2 years of sale. Amount may be determined by fair market value of the property, if homeowner requests it.
Eviction after foreclosure	New owner must serve former owner with three-day notice to quit (leave) and then file eviction (forcible detainer) lawsuit. TX Prop. Code Ann. §§24.002 to 24.005
Servicemember protection	TX Civ. Prac. & Rem. Code §16.022
Foreclosure statute	Tex. Prop. Code Ann. § 51.002

Foreclosure by Court Proceeding (Judicial)

Judicial foreclosure involves the filing of a lawsuit, going to trial, proving that the person owes the money, and asking a judge to rule in the lender's favor. If the judge rules in the lender's favor, the judge normally orders the constable to auction the property off in a foreclosure sale.

In order to file suit, a lawsuit must be prepared, the defendant must be found and served with process and a trial must be held. This is much more expensive than non-judicial foreclosure (more legal fees and court costs) and more time consuming (often a trial date can't be obtained until several months after one is requested.)