

A LENDER'S LEGAL PRIMER ON THE TEXAS REVERSE MORTGAGE

Understanding the Constitutional Compliance Requirements For Creating a Valid Reverse Mortgage Lien on a Texas Homestead

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This article examines the modern Texas reverse mortgage authorized by Section 50(a)(7), and Sections 50(k) – (r) and (v), inclusive, Article XVI, Texas Constitution. Texas' uniquely protective homestead laws and the strict compliance standards historically applied by its courts when determining the validity of a contractual lien on a homestead property are briefly explained. The article then summarizes the constitutional compliance requirements for creating a valid reverse mortgage lien on a homestead property and briefly examines how lenders may shift some of the strict compliance risk to title insurers under Procedural Rule P-45 and may enforce a reverse mortgage lien under the notice and expedited foreclosure procedures of Rules 735 and 736, RCP. Finally, looking forward, new proposed legislation to be introduced by the Texas Mortgage Bankers Association in the upcoming legislative session that would authorize the use of a reverse mortgage to purchase a Texas homestead and require lenders to provide enhanced written consumer disclosures is outlined.

A. Understanding Texas' Uniquely Protective Homestead Law

The uniquely protective homestead law of Texas is embedded in its constitution. Section 50(a), Article XVI, of the Texas Constitution provides that the homestead of a family, or a single adult person, is protected from forced sale for the payment of all debts except for those debts expressly authorized and enumerated in that section. A Texas reverse mortgage is a creation of the state's constitution and was expressly authorized as Section 50(a)(7) by a 1997 constitutional amendment.

The Texas Constitution establishes and guarantees the right of homestead in this manner and sets out limitations for mortgaging the homestead that once distinguished Texas as the only state in the nation in which homeowners could not legally borrow against the built-up equity in their homes. Texas' uniquely protective homestead laws were adopted in the 19th Century at a time when the state was largely a poor,

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agrarian society and, as a matter of public policy, were intended to shield from general creditors a place for the family to live and for the family head to exercise a calling or business for the support of the family.² These constitutional protections, sometimes referred to as the “homestead exemption” or “homestead rights” of Texas homeowners, preclude homeowners from mortgaging their homes for impermissible purposes and preclude general creditors from making lien claims against their homestead properties, even when abstracting judgments. Generally, an urban homestead of up to ten acres of urban property³ or a rural homestead of up to 200 acres of rural property, with a dwelling and other improvements thereon used by a family or a single, adult person as a home, is protected as a homestead.

Texas homestead rights today are embodied in the state’s constitution and various state statutes, including its Property Code, enacted to carry out the purposes of the constitutional provisions.⁴ Beyond merely exempting the homestead from seizure and forced sale by general creditors, however, Texas recognizes homestead rights as being in the nature of an estate in land.⁵ Even a surviving spouse with no ownership interest in the homestead property itself, for example, generally has the right to remain in the homestead, unless abandoned, for the rest of his or her life — a kind of life estate by operation of law. The family homestead cannot be sold, mortgaged, or even abandoned, furthermore, without the consent of both spouses, even if the property is owned solely by just one of them.⁶

Even with their mutual consent, furthermore, a homestead today may only be encumbered for those certain authorized purposes set out as Section 50(a) (1) - (8), Article XVI, of the Texas Constitution, which include purchasing of, making improvements to, or paying taxes on the property; an owelty of partition (e.g., financing of a partitioning by co-owners imposed against the entirety of the property by a court order or by written agreement of the partitioning parties), a refinancing of a valid homestead lien, including a federal tax lien (resulting from tax debt of the owner or, in the case of a family homestead, both spouses); an (a)(6) home equity loan, an (a)(7) reverse mortgage, and an (a)(8) converting of a personal property lien secured on a manufactured home unit to a real property lien on a homestead. Purported liens on homestead for other purposes or created other than in strict compliance with these enabling constitutional provisions are deemed void.

Texas courts have consistently held that a valid lien cannot be created on homestead property in any manner other than in strict compliance with the requirements of the statutes and constitution.⁷ Section 50(c), which provides in pertinent part that “no mortgage, trust deed, or other lien on the homestead shall ever be valid *unless* it secures a debt described by this section,” effectively requires that all constitutional conditions of Section 50 be satisfied to create a valid homestead lien. Because Texas homestead laws are liberally construed by the courts to effectuate the purposes of the constitutional protections, even the innocent failure to satisfy any one of these conditions could be found in a proper case to be fatal to the creation of a valid lien. Unlike a valid judgment lien that may subsequently attach to the real property constituting the homestead if the property loses its homestead character (e.g., through abandonment),⁸ a purported reverse

² 43 Tex. Jur. 3d, *Homesteads* § 2 (1985); *Thomas v. Creager*, 107 S.W.2d 705 (Tex. Civ. App.– Eastland 1937, writ dismiss’d w.o.j.)

³ 1999 amendments to the Texas Constitution and Property Code have increased the size of the urban homestead to not more than 10 contiguous acres of land, with improvements thereon, when used as an urban home or as both an urban home and a place to exercise a calling or business. Acts 1999, 76th Leg., ch. 1510, § 2, eff. Sept. 1, 1999; See Tex. Prop. Code Ann. § 41.002(a), as amended.

⁴ Tex. Const. art. XVI, § 50; Tex. Fam. Code Ann. § 5.81, *et seq.* (Vernon 1993 & Supp. 1995); Tex. Prop. Code Ann. §§ 41.001, *et seq.* (Vernon 1984 & Supp. 1995); Tex. Prob. Code Ann. §§ 270.00, *et seq.* (Vernon 1980 & Supp. 1995).

⁵ See *O’Neil v. Mack Trucks, Inc.*, 542 S.W.2d 112 (Tex. 1976); *Laster v. First Huntsville Properties*, 826 S.W. 2d 125, 129 (Tex. 1991)

⁶ *U. S. v. Rogers*, 103 S. Ct. 2132 (1983), at 2138-2139, on remand 712 F.2d. 990 (1983)

⁷ *Toler v. Fertitta*, 67 S.W.2d 229, 230 (Tex. Comm’n App. 1934, Holding Approved); *In re Daves*, 770 F.2d 1363 (5th Cir. 1985)

⁸ *Matter of Henderson*, 18 F.3d 1305 (5th Cir. 1994, certiorari denied)

mortgage loan that fails to satisfy any one of the constitutional conditions under this rationale arguably would be void and could never constitute a valid lien on the homestead. Moreover, the courts would be expected to find that the homeowner could not waive any of these conditions because each is constitutionally vested.⁹ In any event, a constitutionally deficient lien cannot be estopped into existence,¹⁰ nor can the courts be expected to impose a constructive trust or equitable lien in any case in favor of the lender in absence of compliance with constitutional and statutory requirements for fixing a lien on homestead property.¹¹

B. Constitutional Requirements for Creating a Valid Reverse Mortgage Lien

Texas reverse mortgages are a type of home equity loan authorized by the Texas Constitution that allows senior Texas homeowners, age 62 or older, to borrow against the equity in their homes without having to repay any of the mortgage debt during their lifetimes so long as they continue to live in their homes, properly maintain their homes, and keep their property tax and insurance payments current. All Texas law establishing and regulating the reverse mortgage is contained in the comparatively brief provisions of Section 50, Article XVI, of the Texas Constitution, including specifically subsections 50(a)(7), which authorizes the reverse mortgage, and 50(k) through 50(p), inclusive, and Section 50(v), which define it. There currently are no enabling statutes that implement these constitutional provisions or interpretive guidance, although the power to interpret constitutional home equity and reverse mortgage lending provisions has been expressly delegated to the Texas Finance Commission and the Credit Union Commission effective September 29, 2003. (SB 1067, 78th Tex. Leg. 2003)

Although the Texas reverse mortgage may be thought of as a particular type of home equity loan, it is important to note that the numerous conditions imposed on home equity loans under Section 50(a)(6) are inapplicable to reverse mortgages authorized by Section 50(a)(7). The provisions applicable to home equity loans under Section 50(a)(6), for example, restricting the permitted loan-to-value ratio (80%) and fees and charges (3%), and imposing cooling off and rescission rights and numerous other closing practices, are not carried over to the reverse mortgage provisions. Reverse mortgages nevertheless have their own subset of consumer protections spelled out in subsections 50(k) through 50(p) and 50(v), all of which must be strictly observed by lenders to be assured of creating a valid and enforceable lien on a homestead property. These defining elements of Section 50 include the following conditions:

- 1. *Voluntary Homestead Lien.*** A valid reverse mortgage lien may be created only by written agreement between the lender and each owner of the homestead property and the spouse of each owner. Each owner and each owner's spouse must consent to the lien regardless of whether the spouse claims an ownership interest in the property or is an applicant for, or obligor on, the debt. Each owner or the owner's spouse must be at least 62 years of age. But this requirement varies from the requirements of the HECM and Home Keeper loan programs that require the *youngest* borrower to be 62 years of age, or older. All homestead property, urban or rural, is eligible as security for a reverse mortgage, there being no "carve out" exceptions for homestead property "designated for agricultural use" as in the case of (a)(6) home equity loans.

⁹ *Englander Co. v. Kennedy*, 424 S.W.2d 305 (Tex. Civ. App. – Dallas 1968, writ ref'd n.r.e.)

¹⁰ See *Hruska v. First State Bank of Deanville*, 747 S.W.2d 783 (Tex. 1988)

¹¹ *Fidelity Savings & Loan Association of Port Arthur v. Baldwin*, 416 S.W.2d 482 (Tex. Civ. App. – Beaumont 1967, writ ref'd n.r.e.); *In re Daves*, *supra*

2. *Non-recourse Debt.* A reverse mortgage is non-recourse debt and homeowners have no personal liability for repaying the loan. Homeowners are not required to make any repayments during the term of the loan, and the full loan amount owed, including all amounts advanced and accrued interest (including interest on interest), is typically repaid from sales proceeds when the homestead property is sold by the borrower or by the borrower's estate after the borrower, or the last of the borrowers, dies. When a reverse mortgage becomes due, the lender or note holder must look solely to recovery against the homestead property under its mortgage as its exclusive remedy. The homeowners will never owe more than the loan balance or the value of the homestead property, whichever is less, and no assets of borrowers other than the homestead property may be used to repay the debt. And neither the borrower's estate nor the heirs of the estate have any liability for any deficiency that may result from the sale of the homestead property.

3. *Based on Equity in Homestead.* A reverse mortgage is home equity financing, and the loan amounts or the borrower's eligibility for the loan must be based upon the borrower's age and the appraised equity in the borrower's homestead property only. Accordingly, there must not be restrictions regarding the qualifications of the borrower for the loan based upon the borrower's income, assets, or intended use of the loan funds. For purposes of determining eligibility under any state statute relating to payments, allowances, benefits, or services on a "means-tested" basis (including expressly supplemental security income, low-income energy assistance, property tax relief, medical assistance, and general assistance), reverse mortgage advances made to the borrower are considered loan proceeds and not income; and undisbursed funds under a reverse mortgage loan are considered equity in the home and not loan proceeds.

4. *Repayment; Acceleration; Default; Foreclosure.* The borrower must have no legal obligation to repay a reverse mortgage, or any portion or principal or interest thereon, until the loan balance is declared due and payable (i) upon the death of all borrowers (i.e., the last of the borrowers to die), (ii) upon the sale or transfer of the homestead property, or (iii) after 12 consecutive months in which all borrowers have ceased occupying the homestead property as their principal residence (without having obtained the lender's prior written approval). The lender may also require payment of all principal and interest (iv) if the borrower commits actual fraud in connection with the loan or (v) defaults on an obligation provided for in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property or fails to maintain the priority of the lender's lien on the homestead property. These conditions must be included in the written loan agreement and the lender additionally must provide the homeowner a separate written consumer notice of these conditions at closing. These conditions also are covered in financial counseling that is required of all homeowners before they are eligible to make application for a reverse mortgage.

If seeking foreclosure of a reverse mortgage lien for any reason, the lender must first give written notice to the borrower that a ground for foreclosure exists and give the borrower an opportunity to cure the ground for foreclosure. If the ground for foreclosure is other than the sale of the property or the death of the homeowner, the foreclosure may only be obtained by court order under applicable rules of civil procedure. The content, timing, and manner of delivery of the notice and the constitutionally permitted grounds and methods for foreclosure are described in Section D of this article.

5. *Consumer Notice; Counseling.* The specific conditions enumerated in § 50(k)(6) under which the borrower is required to repay the reverse mortgage loan not only must be included in the written agreement, but the lender must additionally provide written notice of the conditions to the borrower at loan closing. These conditions should also be covered in required counseling for the borrower regarding the "advisability and availability of reverse mortgages and other financial alternatives"

required of borrowers before entering into a reverse mortgage loan. A reverse mortgage may not be made unless the owner of the homestead attests in writing that the owner has received counseling regarding these issues. [Note: Lenders also must provide borrowers with a special written consumer disclosure of the Total Annual Loan Cost Rate substantially similar to the model form found in paragraph (d) of Appendix K to Regulation Z .[12 CFR Part 226, §226.33]

6. *Advances Per Authorized Payment Plan (including Line of Credit Method).* The proceeds of a reverse mortgage must be disbursed to the borrower in one, or more, payments of principal, generally referred to as “advances,” according to an agreed payment plan. The total loan obligation, generally referred to as the “balance,” is the sum of all advances due at loan maturity (including any amounts advanced to cover closing and other costs) plus accrued interest, including interest on interest, and other finance charges, such as mortgage insurance premiums and servicing fees. If the payment plan established by the loan documents calls for more than one advance (i.e., a “lump sum” payment), the advances on a reverse mortgage closed before the 2005 constitutional amendment were required to be made (i) at regular intervals or (ii) at regular intervals in which the amounts advanced may be *reduced* for one or more advances when requested by the borrower, which requirements generally were construed to prohibit *line of credit* terms popular in other states. Effective November 23, 2005, however, Section 50(p), Article XVI, Texas Constitution was amended to authorize line of credit advances under a Texas reverse mortgage. (S.J.R. 7, 79th Tex. Leg. 2005) As amended, Section 50(p) expressly permits a method of advances in which an initial advance may be made at any time and future advances may be made at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached (and, thereafter, subsequent advances may be made at times and in amounts requested by the borrower to the extent that the outstanding balance is repaid). Section 50 also was amended to add a new subsection (v) requiring that a reverse mortgage provide that an advance under a line of credit method may not be obtained by use of a credit card, debit card, preprinted solicitation check, or similar device; that no transaction fee may be charged or collected by the lender after closing solely in connection with any debit or advance; and, that the lender may not unilaterally amend the extension of credit. In addition to advances to the borrower , if the borrower fails to timely pay any of the following for which the borrower is obligated under the loan documents, the lender may at any time advance amounts on behalf of the borrower to pay: (i) property taxes, (ii) assessments, (iii) insurance, and (iv) costs of repairs and maintenance (when performed by persons who are not employed by or affiliated with the lender), or (v) any lien that has, or may obtain, priority over the reverse mortgage lien, to the extent necessary to protect the lender’s interest in, or the value of, the homestead property

7. *Lien Priority; Future Advances.* Advances made, and to be made in the future, under a reverse mortgage, and interest on those advances have lien priority over any subsequently filed lien. Therefore, future advances under a reverse mortgage will have lien priority over any lien filed for record in the real property records of the county where the homestead property is located after the reverse mortgage instrument is filed in that county.

8. *Interest; Shared Appreciation.* Interest may be charged on a reverse mortgage loan at any fixed- or adjustable-rate that the parties may agree upon (and which, if secured by other than a first lien, does not exceed the maximum lawful rate under the Texas Finance Code) and interest may accrue and be compounded during the term of the loan according to the agreed terms of the loan agreement. Furthermore, interest expressly may be contingent upon appreciation in the fair market value of the homestead property, apparently allowing for lenders to charge “equity share” fees based upon the appreciation of appraised value of the homestead when the loan matures. Shared appreciation terms generally reduce the lender’s risk of loss and entitle the borrower to larger monthly advances over the

term of the loan than under other options. [Note: Although authorized by law, under current practice HECM, Homekeeper®, and proprietary reverse mortgage loan programs do not provide for shared appreciation terms.]

9. *Reducing or Failing to Make Advances; Forfeiture.* If an adjustable rate of interest is charged, the lender under a reverse mortgage is expressly prohibited from reducing the amount or number of advances made to the borrower because of an adjustment in the interest rate. The lender is obligated to make loan advances as required by the loan documents under the penalty of forfeiture. If the lender fails for any reason to make loan advances according to the loan documents and, after notice from the borrower, fails to cure the default as required in the loan documents, the Constitution provides that the lender forfeits all principal and interest on the reverse mortgage. However, this forfeiture provision does not apply when a governmental agency, such as FHA under its HECM reverse mortgage insurance, takes an assignment of the loan in order to cure the lender's default.

10. *Preemptive Authority.* Texas reverse mortgage law as authorized and effected by the Texas Constitution expressly supersedes any statutes of this state, including the Texas Property Code, that purport to limit encumbrances that may be fixed on homestead property. Furthermore, a reverse mortgage may be made without regard to any other conflicting state law, including any purported limitations on future advances; a requirement that a maximum loan amount be stated in the reverse mortgage loan documents or that a percentage of reverse mortgage proceeds be advanced before the assignment of the reverse mortgage; or a prohibition on balloon payments, compound interest or interest on interest, or contracting for, charging, or receiving any rate of interest authorized by Texas law.

C. Title Insurance Coverage of Certain Compliance Risks

Texas procedural rules have been adopted to provide the authority for title insurance companies to insure the validity of reverse mortgage liens and for lenders to foreclose reverse mortgage liens under conditions permitted by the Texas Constitution. Specifically, the Texas Commissioner of Insurance approved a reverse mortgage endorsement (T-43) to the standard mortgagee's form of title insurance policy in new Procedural Rule P-45, effective as of June 5, 2000, and the Supreme Court of Texas adopted revisions to the Rules of Civil Procedure, Rules 735 and 736, effective as of April 15, 2000, providing for an expedited procedure for foreclosing reverse mortgage loans requiring a court order as a condition to foreclosure.

Texas mortgage lenders have traditionally sought to shift certain compliance risks to title insurance companies and agencies who act both as insurers against the invalidity or impairment of liens on the homestead property and as settlement agents responsible for closing the transaction. Title insurance in Texas, of course, is a contract of indemnity only — protecting the mortgage lender, in the case of a residential mortgage transaction, against loss suffered by reason of liens, encumbrances upon, or defects in the title to the real property and the invalidity or impairment of the lien created, or intended to be created, by the insured transaction. When securing a mortgage lien on homestead property, title insurers have been relied upon to investigate and make certain factual determinations incident to creation of a valid lien, such as confirmation of the true identity of the parties executing the debt and security instruments, the true character of the real property, the payment of all delinquent taxes on the property, and the passing of the consideration supporting the transaction. The title insurer as settlement agent, furthermore, routinely assures the proper execution, acknowledgment, and delivery of all conveyances, mortgage loan documents, or other instruments that may be necessary to consummation of the transaction, the proper disbursement of proceeds, and the filing in the public records of all appropriate instruments. Because creation of a valid reverse

mortgage lien on homestead property is dependent as a matter of law on strict compliance by the lender with all constitutional conditions, the certitude of compliance that the title insurer can bring to the transaction through its insuring and closing services takes on particular importance.

But the title insurer does not undertake to indemnify the lender against the risk of lien invalidity resulting from claimed violations of constitutional conditions that are not a matter of public record, subject to open observation, or verifiable at a closing conducted by its own title agent. The title insurer generally is insulated from claims of lien invalidity based on violations of the federal Truth in Lending Act entitling the consumer to loan rescission in certain instances and other consumer credit protection laws. This “consumer credit protection law” exclusion is set out as Paragraph 5 under the *Exclusions From Coverage* section of the standard form of Mortgagee Policy of Title Insurance (Form T-2) promulgated by the Texas Department of Insurance as follows:

“The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorney’s fees or expenses that arise by reason of:

...
5. *Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.”*

In undertaking to insure liens created under Section 50(a)(7), the Commissioner of Insurance, effective January 12, 1998, adopted a new form of Reverse Mortgage Endorsement (T-43) and a new related Procedural Rule (Rule P-45) regarding the use of the T-43 Endorsement that incorporates by reference this “consumer credit protection law” exclusion as it pertains to reverse mortgages. Essentially, the T-43 Endorsement expanded the definition of “consumer credit protection law” contained in Paragraph 5 of the Exclusions From Coverage section of the T-2 policy to expressly incorporate “the provisions of Subsections k(3) through k(11), inclusive, of Section 50, Article XVI, Texas Constitution, and any statutory or regulatory requirements for a mortgage made pursuant to Subsection (a)(7).” Claims of lien invalidity arising out of a failure to satisfy one, or more, of the conditions of Section 50(a)(7) or Subsections (k)(3) through (k)11, inclusive, (m) or (p), are excluded from title insurance coverage unless the claim is based on one of the conditions expressly covered under the 1998 version of the T-43 Endorsement, which included variously claims of lien invalidity based on future advances made under a reverse mortgage and failure of the insured mortgage to be created under a written agreement with the consent of each owner and each owner’s spouse.

As amended, most recently after constitutional amendments in 1999, the Texas Reverse Mortgage Endorsement (T-43) to the Mortgagee Title Insurance Policy (T-2) excludes from coverage any loss or damage based on usury or any consumer credit protection or truth in lending law “and/or violation of Subsections (k)(3), (k)(4), (k)(5), (k)(6), (k)(7), (k)(8), (k)(9), (k)(10), (k)(11), (m) (p) or (v) of Section 50, Article XVI, Texas Constitution, and any regulatory or statutory requirements for a mortgage made pursuant to Subsection (a)(7), Section 50, Article XVI, Texas Constitution, *except as expressly provided in paragraph 3 of this endorsement*” (emphasis added). Form T-43 in paragraphs 1 and 2, respectively, insures the validity of future advances made under a reverse mortgage, with certain exceptions, up to the outstanding aggregate amount of loan proceeds actually disbursed and the amount of unpaid, accrued interest thereon as of the time a loss occurs under the policy; and in paragraph 3, Form T-43 expressly insures against loss sustained by the lender under the mortgagee policy because of invalidity or unenforceability of the reverse mortgage lien by reason of any of the following:

- *Written agreement:* the failure of the insured mortgage to be created under a written agreement with the consent of each owner of the insured homestead property and each owner’s spouse [in accordance with subsection 50(k)(1)];

- *Age 62*: the failure of the insured mortgage to be made to a person who is, or whose spouse is, 62 years of age or older [in accordance with subsection 50(k)(2)];
- *Attestation of Counseling*: the failure of the written document purporting to be made pursuant to Subsection (k)(8) to be executed by the homeowner on the date that the insured mortgage and promissory note secured thereby are executed by the owner (provided that the policy does not insure that the document itself complies with subsection 50(k)(8)); or
- *Notice of Repayment Obligation*: the failure of the title company or its agents to furnish the homeowner a copy of written notice purporting to be made pursuant to subsection (k)(9) on the date that the owner executed the insured mortgage and promissory note secured thereby (provided that the policy does not insure that the written document itself complies with subsection 50(k)(9)).

While attachment of the T-43 Endorsement to any mortgage policy of title insurance issued in connection with a reverse mortgage loan is mandatory, under Procedural Rule P-45 the issuing agency may delete any of these four subdivisions of paragraph 3 if it does not consider the additional risk insurable and must delete all four subdivisions if the promissory note and the insured mortgage instrument for the loan are not executed by the borrower at the office of the title company.¹² Furthermore, the insuring agency must delete the second subdivision of paragraph 3 if the age of the owner or spouse is not verifiable “with government issued photographic identification” furnished the title agency and must delete the second and fourth subdivisions if the related documents furnished by the insured are not executed by the homeowner at the office of the title company on the date that the insured mortgage and promissory note secured thereby are executed.

D. The Foreclosure Process

1. Default and Grounds for Foreclosure. Subsection 50(k)(11) provides that a reverse mortgage lien may be foreclosed upon only by a court order if the foreclosure is upon any grounds other than grounds stated in Subsections (k)(6)(A) (i.e., the death of all borrowers) or (k)(6)(B) (i.e., the sale or other transfer of the homestead property). Subsection 50(r) requires the Supreme Court of Texas to promulgate rules of civil procedure for expedited foreclosure proceedings for foreclosure of those reverse mortgage liens that require a court order. The Supreme Court accordingly has adopted revised Rules 735 and 736, Rules of Civil Procedure, for this purpose.

A lender may accelerate the debt and initiate the foreclosure process for a reverse mortgage only after the occurrence of a constitutional ground for foreclosure, delivery of written notice by the lender to the borrower of the claimed ground for foreclosure, and an opportunity for the borrower to remedy the claimed ground for foreclosure in the manner and within a stipulated period of time as provided by the Texas Constitution.

Section 50(k)(6) in that regard defines a reverse mortgage as an extension of credit:

...

(6) that requires no payment of principal or interest until:

(A) all borrowers have died;

(B) the homestead property securing the loan is sold or otherwise transferred;

(C) all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months

¹² The term “office of the title company” includes variously the offices of the insurer, an insurer’s direct operation, a title agency, or a fee attorney conducting business in the name of any of these where the attorney and its bona fide employees who close transactions are licensed as escrow officers under Art. 9.41C, Title Insurance Code.

without prior written approval for the lender; or

(D) the borrower:

- (i) defaults on an obligation specified in the loan documents to repair and maintain, pay taxes and assessments on, or insure the homestead property;
- (ii) commits actual fraud in connection with the loan; or
- (iii) fails to maintain the priority of the lender's lien on the homestead property, after the lender gives notice to the borrower, by promptly discharging any lien that has priority or may obtain priority over the lender's lien within 10 days after the date the borrower receives the notice, unless the borrower:
 - (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to the lender;
 - (b) contests in good faith the lien by, or defends against enforcement of the lien in, legal proceedings so as to prevent the enforcement of the lien or forfeiture of any part of the homestead property; or
 - (c) secures from the holder of the lien an agreement satisfactory to the lender subordinating the lien to all amounts secured by the lender's lien on the homestead property;

Under these exacting constitutional conditions, so long as the borrower, or one of the borrowers, is alive and continues to occupy the homestead property as a principal residence, no loan default can occur unless, under the provisions of Subsection (k)(6)(D), the borrower commits actual fraud in connection with the loan or fails to repair and maintain, pay taxes and assessments on, or insure the homestead property or maintain the priority of the lender's reverse mortgage lien. Defaults under these obligations with respect to the homestead property rarely would be expected because homeowners typically have undertaken the reverse mortgage loan to provide for the resources just for these purposes to maintain and reside in their homes for the rest of their lives. Furthermore, Subsection (p)(3) and the terms of the loan documents provide the lender authority to make advances at any time on behalf of the borrower to pay just such items as delinquent taxes and assessments, insurance, costs of repair or maintenance, or any lien that has, or may obtain, priority over the reverse mortgage lender's lien, to the extent necessary in each case to protect the lender's interest in, or value of, the homestead property.

2. Notice and Acceleration. Before accelerating the debt and commencing foreclosure proceedings in any event, Subsection 50(k)(10) requires the lender to give notice to the borrower "in the manner provided for notice by mail related to the foreclosure of liens under Subsection (a)(6)" regarding home equity loans that a ground for foreclosure exists and that the borrower is given a stated period of at least thirty (30) days in which to:

- (i) Remedy the condition creating the ground for foreclosure;
- (ii) Sell the homestead property and pay the reverse mortgage debt from the proceeds of the sale, or pay the debt from other sources; or
- (iii) Convey the homestead property to the lender by deed in lieu of foreclosure.

Only a cure period of at least 20 days must be given the borrower if the claimed default is a failure of the borrower to maintain the priority of the reverse mortgage lien under Subsection (k)(6)(D)(iii).

3. Methods of Foreclosure. Foreclosure based upon the grounds under Subsections (k)(6)(A) or (B) either that all borrowers have died or that the homestead property securing the loan has been sold or otherwise transferred may be foreclosed upon under the power of sale contained in the deed of trust securing the loan and the requirements of the Section 51.002 of the Property Code, pertaining to non-judicial foreclosure. If the foreclosure is for a ground other than those stated in Subsections (k)(6)(A) and (k)(6)(B), however, a reverse mortgage lien may be foreclosed upon only by court order. Subsection 50(r) in this regard was amended by the 1999 amendment to require the Texas Supreme Court to promulgate rules of civil procedure for expedited foreclosure proceedings related to both Subsection (a)(6) home

equity loans and for those Subsection (a)(7) reverse mortgages that require a court order. Acting under this authority, the Supreme Court approved revisions to Rules 735 and 736 of the Rules of Civil Procedure on February 10, 2000. Rule 735, adopted by the Supreme Court under that legislative directive, provides several judicial foreclosure options for a lender foreclosing a reverse mortgage on grounds other than under Subsection (k)(6)(A) and (k)(6)(B). Under Rule 735, the lender may file (i) a suit seeking judicial foreclosure; (ii) a suit or counterclaim seeking a final judgment that includes an order allowing foreclosure under the security instrument; or (iii) an application for an order allowing foreclosure under Rule 736 pertaining to expedited foreclosure proceedings.

4. Foreclosure Proceedings under Rule 736.

Rule 736, Texas Rules of Civil Procedure, sets out an *in rem* judicial procedure whereby a lender or other holder of a Section 50(a)(6) home equity loan or Section 50(a)(7) reverse mortgage may file a verified application in the district court of the county in which all, or any part, of the secured homestead property is located, seeking a court order allowing a foreclosure in accordance with Section 50(a)(6)(D) for a home equity loan or Section 50(k)(11) for a reverse mortgage under the security instrument and Section 51.002, Property Code. Service is accomplished by delivery of a promulgated form of Notice and a copy of the Application by certified and first class mail addressed to each party who is obligated to pay the debt and is deemed complete when mailed in a properly addressed, postage prepaid wrapper. A Certificate of Service must then be filed with the clerk of the court as *prima facie* evidence of service and must be on file at least ten days (exclusive of the date of filing) before a default order may be entered by the court. A Response by the parties so served is due by the Monday next after the expiration of 38 days from the date of service (i.e., the date of mailing of the Notice and Application), which Response may set out as many matters, whether of law or fact, as the respondent thinks necessary or pertinent to contest the Application.

Under the rule, if no Response is timely made, the court must grant the Application without further notice or hearing if the Application complies in form and content with the requirements of the rule and a copy of the Notice and Certificate of Service has then been on file with the clerk of the court for at least ten days. If a Response is made, however, a hearing on the Application must be set promptly after reasonable notice to the parties and, in any case, not later than ten business days after a request for hearing by either party (unless the parties agree to an extension of time). The rule calls for a streamlined hearing in which no discovery is allowed and the court's action in granting or denying the order may not be appealed. The only issue before the court is the right of the applicant to obtain an order to proceed with foreclosure pursuant to a power of sale under the security instrument and Tex. Prop. Code § 51.002, which sets out the statutory scheme for required notice and procedures for conducting the sale of real property under a power of sale conferred by a deed of trust or other contract lien. The court must grant the Application and issue the order if it determines that the applicant has proved that a valid debt exists that is secured by a lien on the property created under Section 50(a)(6) or Section 50(a)(7); that a default under the security instrument securing that debt exists; and that the applicant has given all requisite notices to cure the default and accelerate the maturity of the debt under the security instrument and applicable law.

If the applicant has failed in that proof, the court must deny the application. In either event, the court's action does not constitute *res judicata* (or collateral or judicial estoppel in any other proceeding or suit) and is without prejudice to the right of either the applicant or respondent to seek relief at law or in equity in any other court of competent jurisdiction. In fact, if the respondent files a petition in the same court or any other district court of the same county contesting the right of applicant to foreclose and files a notice of such action with the clerk of the court before the court has signed an order granting the Application, the proceeding under Rule 736 is automatically abated and the Application dismissed. Once the order

granting the Application has been entered, however, the homeowner would be put to the task of obtaining and serving a Temporary Restraining Order, or TRO, to forestall the foreclosure process. When entered, a copy of the Rule 736 order together with the notice of sale must be sent to the respondent and a certified copy of the order must be filed in the real property records of the county in which the property is located within ten days after entry of the order (although failure to timely record the order expressly does not affect the validity of the foreclosure).

E. On the Horizon — Proposed Amendment to Texas Constitution to Enhance Consumer Disclosures and to Authorize Use of a Reverse Mortgage to Purchase a Homestead

The Texas Mortgage Bankers Association, through the efforts of Past President Scott Norman and General Counsel John Fleming, now has on its legislative agenda for the 2013 session of the Texas Legislature a proposed joint resolution that would authorize the use of a reverse mortgage to purchase a homestead, thereby qualifying Texas homeowners for participation in FHA's HECM for Purchase loan program, and also require enhanced consumer disclosures for all reverse mortgages in Texas. A draft of the proposed Joint Resolution is attached to this article as Exhibit A. With reference to the draft resolution:

Section 1 would amend Section 50(k)(4) to clarify that a reverse mortgage loan can be used to finance the purchase of a home. Because a reverse mortgage currently is defined in part as an extension of credit under which advances are provided *based on equity* in the borrower's homestead, the legal authority needed to create a valid reverse mortgage lien is unclear when the loan proceeds are to be used to finance the purchase of a homestead in which no equity exists at the time of making the loan.

Section 2 would amend Section 50(k)(6) to provide that a lender may declare a default and ground for foreclosure if a borrower using a reverse mortgage to purchase a homestead fails to occupy the homestead property as a principal residence within the time period required by the loan documents. This provision would conform the Texas reverse mortgage requirements to that of FHA's HECM for Purchase loan program requiring currently that the borrower begin occupying the secured property as a principal dwelling within 60 days after loan closing.

Section 3 would amend Section 50(k)(8) regarding mandatory counseling of the borrower before closing. The amendment would substitute the term "borrower and borrower's spouse" for "owner of the homestead property." Because a consumer who uses a reverse mortgage to purchase a home does not become an owner until closing, this change clarifies that mandatory counseling prior to making the loan is required for all consumers who apply for a reverse mortgage loan.

Section 4 would amend Section 50(k)(9) to provide that a lender may not close a reverse mortgage loan before the 12th day after the lender provides the borrower a new promulgated form of written consumer disclosure on a separate instrument. This disclosure requirement would apply to all reverse mortgages, including a reverse mortgage for purchase, and is intended to enhance and strengthen the current disclosure required under Section 50(k)(9) by informing the consumer clearly and conspicuously that consumers may lose their homes to foreclosure in certain events, such as the failure to pay property taxes, maintain property insurance, or to maintain the property in a good condition and state of repair. The notice language has been drafted in plain language with the intent to make it as understandable as possible while tracking the substantive provisions of current law as closely as possible.

Section 5 would provide for the amendment to be placed on the ballot for voter approval at an election in November, 2013 and sets out the precise ballot language.

Although its adoption is not assured, since first authorizing reverse mortgage loans on homesteads through an amendment to the Texas Constitution in 1997, the Texas Legislature has demonstrated a willingness from time to time to enact amendatory resolutions as needed to make corrections or enhancements in the defining provisions of the constitution. Notably, a 1999 amendment corrected a flawed definition that appeared to restrict the ability of a lender to call a reverse mortgage loan upon the death of the homeowner or the abandonment of the homestead by the homeowner. Legislation enacted in the 2003 legislative session¹³ also amended provisions of the Texas Constitution that formerly prohibited using the proceeds of a reverse mortgage to refinance an existing home equity loan secured on a Texas homestead property.¹⁴ As amended, reverse mortgages today expressly may be used by senior homeowners to refinance home equity loans. This amendment restores the promise of reverse mortgage benefits to those senior Texas homeowners who unwittingly took out home equity loans during the three-year hiatus after the 1997 Amendment before reverse mortgages became generally available in Texas in late 2000. A 2005 Amendment also authorized for the first time a line of credit method of advances under a Texas reverse mortgage, which now enables senior Texas homeowners to better regulate the extent and costs of their borrowings and the preservation of their estates.

Constitutional amendments are not insignificant undertakings, of course. Amendments to the Texas Constitution require a joint resolution approved by a super-majority vote of both houses and a majority vote at public referendum in November following the biennial legislative session. But assuming its adoption in November, 2013, this proposed constitutional amendment will provide an important new financing option for Texas seniors who wish to downsize their homes to economize, relocate to be nearer their families or medical care, or simply to purchase age appropriate housing. ♦

¹³ 77(R) H.J.R. 4, Sec. 2

¹⁴ Tex. Const., art. XVI, § 50(f), effective September 28, 2003 now reads as follows:

(f) A refinance of debt secured by the homestead, any portion of which is an extension of credit described by Subsection (a)(6) of this section, may not be secured by a valid lien against the homestead unless the refinance of the debt is an extension of credit described by Subsection (a)(6) or (a)(7) of this section.

Exhibit A

By _____

_____ J.R. No. ____

A JOINT RESOLUTION

proposing a constitutional amendment to authorize the making of a reverse mortgage loan for the purchase of a homestead property and requiring consumer disclosures for a reverse mortgage.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Subsections(k)(4), of Section 50, Article XVI, Texas Constitution, is amended to read as follows:

(k) "Reverse mortgage" means an extension of credit:

(1) that is secured by a voluntary lien on homestead property created by a written agreement with the consent of each owner and each owner's spouse;

(2) that is made to a person who is or whose spouse is 62 years or older;

(3) that is made without recourse for personal liability against each owner and the spouse of each owner;

(4) under which advances are provided to a borrower based on the equity in a borrower's homestead, or advances are provided to a borrower for the purchase of a homestead property that the borrower will occupy as a principal residence;

SECTION 2. Subsections(k)(6)(C) of Section 50, Article XVI, Texas Constitution, is amended to read as follows:

(6) that requires no payment of principal or interest until:

(A) all borrowers have died;

(B) the homestead property securing the loan is sold or otherwise transferred;

(C) all borrowers cease occupying the homestead property for a period longer than 12 consecutive months without prior written approval from the lender; or, if the extension of credit is used for the purchase of a homestead property, the borrower fails to timely occupy the homestead property as the

borrower's principal residence within a period of time after the extension of credit is made that is stipulated in the written agreement creating the lien on the homestead property; or

SECTION 3. Subsection (k)(8) of Section 50, Article XVI, Texas Constitution, is amended to read as follows:

(8) that is not made unless ~~the owner of the homestead~~ the borrower and the borrower's spouse attest in writing that the borrower and the borrower's spouse received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives;

Section 4. Subsection (k) (9) of Section 50, Article XVI, Texas Constitution is amended to read as follows:

(9) ~~That requires the lender, at the time the loan is made, to disclose to the borrower by written notice the specific provisions contained in Subdivision (6) of this subsection under which the borrower is required to repay the loan;~~ that is not closed before the 12th day after the lender provides the borrower the following written notice on a separate instrument :

IMPORTANT NOTICE TO BORROWERS
RELATED TO YOUR REVERSE MORTGAGE

THE LENDER MAY FORECLOSE THE REVERSE MORTGAGE AND YOU MAY LOSE YOUR HOME IF:

1. YOU DO NOT PAY THE TAXES OR OTHER ASSESSMENTS ON THE HOME;
2. YOU DO NOT MAINTAIN AND PAY FOR PROPERTY INSURANCE ON THE HOME AS REQUIRED BY THE LOAN DOCUMENTS;
3. YOU FAIL TO MAINTAIN THE HOME IN A STATE OF GOOD CONDITION AND REPAIR;
4. YOU CEASE OCCUPYING THE HOME FOR A PERIOD OF LONGER THAN 12 CONSECUTIVE MONTHS WITHOUT THE PRIOR WRITTEN APPROVAL FROM THE LENDER AND, IF THE EXTENSION OF CREDIT IS USED FOR THE PURCHASE OF THE HOME, YOU FAIL TO TIMELY OCCUPY THE HOME AS YOUR PRINCIPAL RESIDENCE WITHIN A PERIOD OF TIME AFTER THE EXTENSION OF CREDIT IS MADE THAT IS STIPULATED IN THE WRITTEN AGREEMENT CREATING THE LIEN ON THE HOME;
5. YOU SELL THE HOME OR OTHERWISE TRANSFER THE HOME WITHOUT PAYING OFF THE LOAN OR OBTAINING THE LENDER'S CONSENT;
6. ALL BORROWERS HAVE DIED AND THE LOAN IS NOT REPAYED;

7. YOU COMMIT ACTUAL FRAUD IN CONNECTION WITH THE LOAN; OR

8. YOU FAIL TO MAINTAIN THE PRIORITY OF THE LENDER'S LIEN ON THE HOME, AFTER THE LENDER GIVES NOTICE TO YOU, BY PROMPTLY DISCHARGING ANY LIEN THAT HAS PRIORITY OR MAY OBTAIN PRIORITY OVER THE LENDER'S LIEN WITHIN 10 DAYS AFTER THE DATE YOU RECEIVE THE NOTICE, UNLESS YOU:

(A) AGREE IN WRITING TO THE PAYMENT OF THE OBLIGATION SECURED BY THE LIEN IN A MANNER ACCEPTABLE TO THE LENDER;

(B) CONTEST IN GOOD FAITH THE LIEN BY, OR DEFEND AGAINST ENFORCEMENT OF THE LIEN IN LEGAL PROCEEDINGS SO AS TO PREVENT THE ENFORCEMENT OF THE LIEN OR FORFEITURE OF ANY PART OF THE HOME; OR

(C) SECURE FROM THE HOLDER OF THE LIEN AN AGREEMENT SATISFACTORY TO THE LENDER SUBORDINATING THE LIEN TO ALL AMOUNTS SECURED BY THE LENDER'S LIEN ON THE HOME

IF A GROUND FOR FORECLOSURE EXISTS, THE LENDER MAY NOT COMMENCE FORECLOSURE UNTIL THE LENDER GIVES YOU WRITTEN NOTICE BY MAIL THAT A GROUND OF FORECLOSURE EXISTS AND GIVES YOU AN OPPORTUNITY TO REMEDY THE CONDITION CREATING THE GROUND FOR FORECLOSURE OR TO PAY THE REVERSE MORTGAGE DEBT WITHIN THE TIME PERMITTED BY LAW.

YOU SHOULD CONSULT WITH YOUR HOME COUNSELOR IF YOU HAVE ANY CONCERNS ABOUT THESE OBLIGATIONS BEFORE YOU CLOSE YOUR REVERSE MORTGAGE LOAN.

THIS NOTICE IS ONLY A SUMMARY OF YOUR RIGHTS UNDER THE TEXAS CONSTITUTION. YOUR RIGHTS ARE GOVERNED BY SECTION 50 ARTICLE XVI, OF THE TEXAS CONSTITUTION, AND NOT BY THIS NOTICE.

SECTION 5. This proposed constitutional amendment shall be submitted to the voters at an election to be held November ____, 2013. The ballot shall be printed to permit voting for or against the proposition: "The constitutional amendment to require consumer disclosures for a reverse mortgage and to authorize the making of a reverse mortgage loan for the purchase of a homestead property."