

BROWN, FOWLER & ALSUP

A Professional Corporation
Attorneys at Law

J. Alton Alsup
*Board Certified in Residential Real Estate Law
Texas Board of Legal Specialization*

8955 Katy Freeway, Suite 305
Houston, Texas 77024
www.LoanLawyers.com

Telephone 713/468-0400
Facsimile 713/468-5235
AIAlsup@BFAlegal.com

MEMORANDUM

TO: Clients and Friends of the Firm

FROM: Al Alsup

DATE: April 20, 2004

SUBJECT: **Overview of New Procedures for Titling and Permanent Financing of Manufactured Homes Attached to Real Property under Texas Property and Homestead Laws (SB 521, Effective September 1, 2003)**

1. The Traditional Texas Practice (Old Way) of Permanently Financing Manufactured Homes as Homestead Real Property. Financing new manufactured homes as traditional first-lien residential mortgage loans when being permanently attached to real property that is, or is to be, the homestead of the borrower has always been a conveyancing challenge to the Texas practitioner. The permanent financing of manufactured homes purchased originally as personal property under an installment sales or similar contract has required a stepped process by which the manufactured home is transported to the homeowner's lot or tract, permanently attached to a foundation, connected to utilities, its permanent attachment evidenced by an affidavit recorded in the real property records, and the title certificate or manufacturer's certificate of origin surrendered for cancellation to the Texas Department of Housing and Community Affairs (TDHCA), which then typically issued a certificate of cancellation within 60 days, completing the process for terminating the legal status of the manufactured home as personal property and making the lot and the newly installed manufactured home eligible to be financed as real property. To affix an effective lien on the homestead property, it was necessary during this process to create one, or more, mechanic's and materialman's liens, or so-called "M&M liens," under the provisions of Section 50(a)(5), Article XVI, Texas Constitution, to cover the costs of paying off the balance owed under the installment sales contract (treating the manufactured home and its component parts as "materials" incorporated into the improvements) and the costs of materials and labor incorporated into constructing a concrete or other foundation and other improvements such as a septic tank, driveway, decking and fencing, permanent attachment of the manufactured home unit to the foundation, and connection of the manufactured home to utilities such as electricity, water, gas, and waste water services. Once permanent installation of the manufactured home and other improvements were completed and valid constitutional liens created for those purposes, a traditional first-lien residential mortgage lien could then be created on the homestead property to refinance the indebtedness secured by the M&M lien, or liens, and any secured purchase money indebtedness that may be outstanding on the lot or tract by expressly renewing and extending those liens and transferring them to the permanent mortgage lender to secure a new first-lien deed of trust for the benefit of the permanent mortgage lender.

2. The Complications of the 2001 Constitutional Amendment to Authorize Conversion of Manufactured Homes Personal Property Liens to Homestead Real Property Liens. The Texas Property Code was first amended effective September 1, 1999, to authorize an automatic conversion of a personal property lien on a manufactured home to a real property lien. Under § 62.003, Texas Property Code, (since renumbered § 63.003) when a manufactured home converts to real property (i.e., when, under the law as it then existed, the manufactured home was permanently attached to real property, the manufacturer's certificate of origin or original document of title surrendered to the TDHCA, and a Certificate of Attachment filed in the county real property records under the then provisions of § 2.001, Tex. Prop. Code) the personal property lien on the manufactured home is converted to a purchase money lien on real property by operation of law and exists independently of any other lien that may be attached to the same real property.

However, the Attorney General of Texas in his Opinion No. JC-0357 issued March 27, 2001, concluded that the provisions of § 62.003 authorizing such a lien were unconstitutional and did not create a valid purchase money lien on homestead property. The Attorney General reasoned that the meaning of homestead *purchase money debt* authorized by the Section 50(a)(1) must be strictly construed and that the term cannot be expanded to encompass a whole new category of debt that is authorized by statute to be secured by a lien on the homestead i.e., the purchase price debt for manufactured homes.

Within weeks after publication of the AG opinion, title insurers generally had withdrawn from insuring loans under the T-31 Manufactured Home Endorsement, which relied on § 62.003 as authority for converting the combined indebtedness of an existing land loan and an existing loan secured on a manufactured home unit under a retail installment contract into a real property lien on a homestead. Title companies continued to insure those loans if the purchase and installation of the unit instead was secured by a mechanic's lien in the traditional fashion. The 77th Legislature, which was in session when the flak arose, responded to the emergency by passing H.J.R. 5 to provide the necessary constitutional underpinnings for § 62.003. H.J.R. 5 proposed to amend Section 50(a) by adding a new subsection 50(a)(8) expressly providing the supporting constitutional authority for the enabling provisions of the existing Section 62.003 (now renumbered as Section 63.003).

Section 50(a)(8), as approved by Texas voters in November and effective January 1, 2002, creates as a new category of debt that may be secured by a consensual lien on a homestead:

Sec.50. (a) The homestead of a family, or a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for :

. . .

- (8) the conversion and refinance of a personal property lien secured by a manufactured home to a lien on real property, including the purchase price of the manufactured home, the cost of installing the manufactured home on the real property, and the refinance of the purchase price of the real property.

With the underlying constitutional authority thus established for the conversion of a personal property lien on a manufactured home unit to a real property lien on a homestead, the constitutionality of § 63.003 (renumbered from § 62.003 by Acts 2001, 77th Leg. Ch. 1420, §21.001(96), eff. Sept. 1, 2001) challenged in AG Opinion No. JC-0357 would now seem unassailable. Its practical application, however, was less assured considering extensive 2001 amendments under H. B. 1869 to the Texas Property Code, the Texas Manufactured Housing Standards Act, and the Tax Code regarding the sale, financing, titling, and taxation of manufactured homes. The 77th Legislature in the 2001 legislative session created a new but confusing statutory scheme for effecting the sale and permanent mortgage financing of manufactured homes when permanently attached to homestead real property through the amendments of sections 6A, 19(1), 19(A), and 21 of the Texas Manufactured Housing Standards Act ("TMHSA"), article 5221f, V.T.C.S., (now codified in Chapter 1201, Texas Occupations Code) and sections

2.001, 62.004 and 62.005 (now renumbered as sections 63.004 and 63.005, respectively), Texas Property Code. Those statutory provisions contained conflicting and ambiguous definitions that determined when a manufactured home was deemed at law to have converted from personal property to real property and set out a burdensome scheme requiring numerous filings of documents at various stages to effect the conversion at law, including variously a notice of attachment, a notice of improvement attachment, a notice of installation, and a certificate of attachment. However, SB 521 enacted by the 78th Legislature effective September 1, 2003 has simplified the process for titling manufactured homes and for converting a personal property lien on a manufactured home unit to a real property lien under Texas law.

3. Overview: The SB 521 Amended Texas Practices and Procedures (New Way) for Titling and Permanently Financing Manufactured Homes as Homestead Real Property, Effective September 1, 2003.

The new practices and procedures required of retailers and mortgage lenders under the statutory scheme effective September 1, 2003 are outlined here for the usual case involving the first retail sale and mortgage financing of a new manufactured home that is to be directly installed by the retailer on a lot or other real property titled in the name of the buyer/borrower under a deed or contract of sale.

The new Texas procedures for titling and perfecting liens on manufactured homes attached to real property are controlled by Chapter 1201 of the Texas Occupations Code, which codifies the Texas Manufactured Housing Standards Act (“Standards Act”), and §§2.001 and 63.001–63.005, inclusive, of the Texas Property Code. The new procedures for titling and perfecting a homestead lien differ in some respects depending on whether the transaction is to (i) finance the “first retail sale” of a manufactured home occurring on or after September 1, 2003 by a retailer who will permanently install the manufactured home directly on real property titled in the name of the buyer/borrower under a deed or contract of sale, (ii) finance a resale by a financial institution or a retailer of a manufactured home that is to be permanently installed directly on real property titled in the name of the buyer/borrower under a deed or contract of sale, (iii) finance a “subsequent sale” of a manufactured home from one person to another after the first retail sale and initial issuance by the TDHCA of a document of title, or (iv) refinance a lien on a manufactured home that was permanently attached to real property before September 1, 2003.

The Texas Department of Housing and Community Affairs (“TDHCA”) no longer issues a title certificate or other document of title for any new and untitled manufactured home at the first retail sale of a manufactured home that is to be permanently installed by the retailer on a lot or other real property titled in the name of the buyer/borrower under a deed or contract of sale. Beginning September 1, 2003 the document of title with respect to a manufactured home is designated a Statement of Ownership and Location, which is issued by the TDHCA under the provisions of §1201.214 of the Standards Act. Under the new statutory titling scheme, a Manufacturer’s Certificate of Origin (“Manufacturer’s Certificate”) for any manufactured home unit is no longer considered evidence of title to the unit when the first retail sale occurs (and Manufacturer’s Certificates securing a retailer’s inventory of units convert to security interests in cash and cash proceeds from sales upon the first retail sale). Furthermore, all outstanding title certificates or other documents of title for manufactured homes issued by the TDHCA prior to September 1, 2003 are now considered to be Statements of Ownership and Location and may be exchanged with the TDHCA for replacement Statements of Ownership and Location under §1201.214. A manufactured home may only be titled and treated as real property if the owner of the home has elected to treat the home as real property and a certified copy of the Statement of Ownership and Location for the home issued by the TDHCA has been filed in the real property records of the county in which the home is located. Steps for titling of a manufactured home are generally set out in §§1201.205 – 1201.207 of the Standards Act.

Procedures for Titling and Mortgage Financing of a New Manufactured Home.

The 2003 amendments clarified that a purchaser of a new manufactured home from a licensed retailer may elect to finance the purchase of the home by a mortgage loan secured by real property or by a chattel

mortgage secured by personal property under the Standards Act. A manufactured home may only be mortgaged as real property if the owner of the home has elected to treat the home as real property and a certified copy of the Statement of Ownership and Location for the home issued by the TDHCA has been filed in the real property records of the county in which the home is located. Only the steps necessary to finance the manufactured home as real property are outlined here:

Titling of New Manufactured Home as Real Property.

- ***Providing Application Form to Purchaser by Retailer.*** Before the first retail sale of a manufactured home, the retailer must timely provide to the purchaser an application for the issuance by the TDHCA of a Statement of Ownership and Location and any information needed by the purchaser to complete the application.
- ***Filing of Completed Application by Retailer.*** At the first retail sale of the manufactured home, the retailer must provide for the installation of the home and ensure that the application for the issuance of the Statement of Ownership and Location is properly completed by the purchaser and returned to the retailer for filing with the TDHCA. The retailer must provide the completed application to the TDHCA not later than the 30th day after the date of the first retail sale. The retailer may, but is no longer required to, surrender the Manufacturer's Certificate for the manufactured home with the application. Ownership of the manufactured home does not pass to or vest in the purchaser until the completed application for the Statement of Ownership and Location is filed with the TDHCA.
- ***Processing of Application by TDHCA.*** The TDHCA must process the completed application and issue or reject the Statement of Ownership and Location not later than the 10th working day after its receipt. When issuing the Statement of Ownership and Location, the TDHCA must retain the original of the statement in its files and mail a certified copy of the Statement of Ownership and Location to the purchaser and to any lienholder. (Any subsequent issuance by the TDHCA of a Statement of Ownership and Location upon sale or other transfer of title of the manufactured home generally requires that any lienholder shown on the statement first give its written consent or release its interest.) If the TDHCA rejects the application, it must provide a clear and complete explanation of the reason for rejection and instructions on how to cure any defects, if possible.
- ***Titling as Real Property.*** The manufactured home constitutes real property only if and when the purchaser elects (in affidavit form) to treat the home as real property and files a certified copy of the Statement of Ownership and Location for the manufactured home in the real property records of the county in which the manufactured home is located. After filing the certified copy of the Statement of Ownership and Location, the manufactured home is considered to be real property in the form of an improvement to the underlying land on which the home is located and any lien on the unit in the nature of a vendor's lien or purchase money lien is converted to a real property lien on the land and improvements constituting the real property.

Financing of Purchase of New Manufactured Home as Real Property.

- ***Consumer Notice.*** Before the completion of a credit application to finance the purchase of a manufactured home, the retailer or its agent must provide to the applicant a promulgated form of consumer notice set out as §1201.162 of the Standards Act (See TDHCA Form 1038/162 Notice attached). The notice must be printed in at least 12-point type and not be attached to, or combined with, any other written material. The notice informs the consumer about items that should be considered when buying a manufactured home that will be placed on land that the consumer owns or will purchase, including zoning and restrictive covenants, water availability and sewer connections, homeowner association fees, property taxes and insurance, and the option available to the consumer to finance the purchase by either a real estate mortgage or a chattel (personal property) mortgage. Amendments to the notice also inform the consumer that (i) the consumer has the right to

rescind the purchase contract within three days after the date of signing the contract without penalty or charge, (ii) that the consumer must install an on-site septic tank facility if the lot is not serviced by a municipal or utility district sewer system, and (iii) that the manufactured home will be subject to ad valorem property taxes, which must be escrowed monthly with each monthly payment to the lender (unless the lender is a federally insured financial institution and does not otherwise require the escrow of taxes in connection with its residential real property loans).

- ***Permanent Installation on Real Property.*** A retailer selling a new manufactured home also is responsible for its installation and must warrant the proper installation of the home in accordance with TDHCA rules set out in §80.119 of the Texas Administrative Code. The retailer must permanently install the manufactured home on the lot or other real property titled in the name of the consumer under a deed or contract of sale. The manufactured home must be permanently attached to the real property, which now means it must be secured to a foundation and connected to a utility, including one or more of the following: water, electric, natural gas, propane or butane gas, or waste water services. The manner of installation must satisfy the lending requirements of the Federal Housing Administration (FHA), Fannie Mae, or Freddie Mac for long-term mortgage loans or FHA insurance, and, in addition to applicable state standards, must meet the manufacturer's specifications required to validate the manufacturer's warranty.
- ***Filing of Statement of Ownership and Location.*** A manufactured home becomes new improvements to the homestead of a family or a single adult person upon the filing of the Statement of Ownership and Location issued by the TDHCA in the real property records of the county in which the home is permanently attached to real property (§ 63.005, Tex. Prop. Code). The indebtedness for the manufactured home (including presumably the purchase price of the manufactured home, related closing costs and fees, and the costs of installing the manufactured home on real property if contracted for in writing, such as in an installment sales contract) is considered to be for work and materials used in constructing new improvement on the homestead and, upon recording the Statement of Ownership and Location, constitutes a valid lien on the homestead.
- ***Closing at Office of Financial Institution, Title Company, or Attorney at Law.*** Closing of the purchase and sale of a manufactured home to be permanently attached to real property that is titled in the name of the purchaser under a deed or contract of sale must be conducted at the office of a federally insured financial institution, a title company, or an attorney at law and cannot be held at the offices of the retailer. If the real property is purchased under a contract of sale (i.e., a contract for deed), the contract must be filed in the real property records of the county in which the home is installed. Title companies require closings of permanent financings be conducted through the office of a direct branch operation or agency as a condition of issuance of the T-31 and T-31.1 endorsements, which insure that the manufactured home is located on the lot, that the manufactured home is real property, that the borrower is the owner of the real property, that no financing statement or other personal property lien or federal tax lien has attached to the manufactured home, and that the lender's lien is a valid first lien on the manufactured home and the real property to which it is permanently attached.
- ***Source of Closing Costs.*** No part of the down payment of the purchase price of the manufactured home nor the payment of any fees, points, or other charges, or any "buy downs" (presumably of prevailing points or interest rate) may be made from funds provided by the seller of the lot or other real property purchased, or to be purchased, by the buyer/borrower or any person acting on the seller's behalf. The retail installment contract or other contract document and the HUD-1 Settlement Statement accordingly should be reviewed for compliance with this prohibition and the lender's Closing Instructions to the settlement agent should require that no such charges be allocated to the seller of the subject real property.

- ***Closing Documentation for Permanent Mortgage Loan.*** Once the Statement of Ownership and Location is filed of record, the permanent home mortgage financing of the purchase price of the manufactured home (and related fees and charges), costs of its installation, and, if applicable, the purchase of the lot on which it is situated, may be documented in the conventional manner common to Texas homestead refinance loans utilizing the identical forms of note, deed of trust, and other legal instruments, with the addition of a Manufactured Home Rider and a Renewal and Extension Rider consistent with Texas practice. The R&E Rider should describe with some specificity the indebtedness secured on the homestead property and each of the liens that will be renewed, extended, and carried forward through their transfer and assignment to the mortgage lender, including (i) the loan or “credit advance” document for the purchase of the manufactured home, such as a retail installment contract (Note in this regard that the loan or credit advance document creating a lien on the manufactured home must “state or indicate” that the lien is, or is in the nature of, a vendor’s lien, a purchase money lien, or a retail installment contract); (ii) any separate debt for the costs of permanent installation of the manufactured home contracted for in writing that are not covered in the credit advance document described in (i); (iii) any separate debt not covered by (i) or (ii) that is secured by a mechanic’s and materialman’s lien for the construction of other improvements to the homestead property, such as a concrete slab foundation, a septic tank, extension of utility lines, fencing, decking, paving and landscaping; and (iv) any balance owing on purchase money indebtedness that is secured on the homestead property by a vendor’s lien and/or a purchase-money deed of trust. The rider, of course, should contain express contractual subrogation rights and a partial lien invalidity provision.

4. Titling and Financing of Used and Relocated Manufactured Homes. At a subsequent sale or transfer of a manufactured home, the purchaser or transferee must apply with the TDHCA for the issuance of a new Statement of Ownership and Location. Ownership of the manufactured home does not pass or vest until the purchaser or transferee has filed a completed application for a Statement of Ownership and Location with the TDHCA. If the owner of a manufactured home relocates the home, the owner must apply for the issuance of a new Statement of Ownership and Location not later than the 30th day after the date the home is relocated in accordance with the requirements of the Texas Department of Transportation and attached to real property. However, the TDHCA may issue a subsequent Statement of Ownership and Location for the home only if all lienholders and parties in interest as reflected in the department’s records have given their written consent to the issuance or released their interests either in writing or by operation of law. One important exception to this rule permits the TDHCA to issue the Statement of Ownership and Location before the release of any liens or the consent of any lienholders is obtained if the release of a certified copy of the statement is made only to either a licensed title insurance company that has issued a title policy covering all prior liens or a federally insured financial institution or licensed attorney who has obtained such a policy of title insurance covering all such prior liens on the home.

THIS MEMORANDUM IS PROVIDED FOR THE GENERAL INFORMATION OF THE CLIENTS AND FRIENDS OF OUR FIRM ONLY AND IS NOT INTENDED AS SPECIFIC LEGAL ADVICE. YOU SHOULD NOT PLACE RELIANCE ON THIS GENERAL INFORMATION ALONE BUT SHOULD CONSULT COUNSEL REGARDING THE APPLICATION OF THE LAWS AND REGULATIONS DISCUSSED IN THIS MEMORANDUM TO YOUR SPECIFIC CASE OR CIRCUMSTANCES.