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MEMORANDUM

TO: Clients and Friends of the Firm

FROM: J. Alton Alsup

DATE: September 22, 2003

SUBJECT: Constitutional Home Equity Amendments will require Texas Lenders to Provide Two New Disclosures and Revamp their Closing Procedures as Early as September 29, 2003.

Texas voters at the Special Election held September 13, 2003, approved Propositions 6 and 16, which amend the Texas Constitution to enact significant home equity loan reform measures proposed by SJR 42, a joint resolution of the 78th Texas Legislature.¹ These constitutional amendments will be effective on the date of the official canvass of the election returns, which will occur as early as September 29 or as late as October 13, 2003 (the “Effective Date”).

While these reform measures are generally favorable to mortgage lenders and consumers alike, mortgage lenders should be aware of two particular new consumer notice requirements that present operational challenges to Texas lenders seeking to close home equity loans on or after the Effective Date of the amendments:

1. ***Amended 12-Day Notice of Extension of Credit.*** The Section 50(g) notice that must be given homeowners to commence the 12-day “cooling off” period before a home equity loan may be closed was amended, and lenders will have to (i) deliver the amended 12-Day Notice to homeowners with pending loan closings as of the Effective Date, and (ii) reschedule those closings for a date 12 or more calendar days later. This may result in a one-time, 12-day hiatus after the Effective Date in which no Texas home equity loans may be closed. Based on our understanding of an earlier Attorney General Opinion (DM-452) opining on the effectiveness of a proposed delivery of the 12-Day Notice prior to its January 1, 1998 effective date, we believe that delivery of the amended form of 12-Day Notice to home equity loan applicants prior to the Effective Date when it is given legal effect would not satisfy the constitutional notice requirement. Applicants for home equity loans on or after the Effective Date must be given the amended form of 12-Day Notice as well. The content of the 12-Day Notice was amended in several respects to correct certain defective language, add new disclosures regarding HELOCs, and

¹ See our Client Memorandum dated July 25, 2003 titled *Significant Home Equity Loan Reform Measures in the Offing: SJR 42 Proposes Constitutional Amendment for Approval by Voters on September 13, 2003* for a detailed summary of all home equity reform measures proposed by SJR 42 and Proposition 16 at www.LoanLawyers.com under Legal Articles tab.

clarify that actual constitutional language prevails over inconsistent summaries of consumer rights in the promulgated notice. A copy of the amended 12-Day Notice that must be given homestead owners on and after the Effective Date is attached to this memorandum as Exhibit A.

2. ***New 1-Day Notice of Actual Fees and Charges.*** A new written disclosure itemizing final fees, points, interest and costs that will be charged at closing will have to be given to homestead owner(s) at least one business day before the date of closing for all home equity loans closed after the Effective Date. To satisfy this requirement, we anticipate that homeowners will be required to present themselves at the office of the title company or agent serving as settlement agent during usual business hours one business day prior to the scheduled closing of a home equity loan to receive, and acknowledge receipt of, a copy of the final HUD-1 Settlement Statement. This practice will require that lenders and title agents serving as settlement agents significantly alter their current practices and procedures in order to determine final, unalterable figures and provide a written itemization of all such amounts to all homestead owners one business day prior to a scheduled loan closing.

In absence of formal rulemaking by the Insurance Department, title agents would have to agree to prepare the final HUD-1 Settlement Statement and make it available at its office for inspection and receipt by homeowners during usual business hours one business day prior to a scheduled closing. Mortgage lenders and brokers for their part would have to agree to provide their loan documentation, including particularly their final closing instructions itemizing the payees and all authorized fees and charges, at least two (2) business days prior to a scheduled closing to allow the time needed by the title agent to compile data on final fees and charges from all sources and prepare a final form of HUD-1 Settlement Statement approved by the lender that day. Either the lender or title agent then would have to instruct homeowners to personally call for their advance copy of the final HUD-1 Settlement Statement at a designated office of the title agent at or after a designated time the following business day preceding the scheduled date of closing. Once receiving this advance copy of the final HUD-1 Settlement Statement, any change in any fee or other charge by the lender, title company, or other settlement service provider would have the consequence of delaying the closing by at least one additional business day because the closing would have to be rescheduled for a later date not less than one business day after the homeowners receive a revised form of HUD-1 Settlement Statement disclosing the revised fees and charges. We anticipate that the Insurance Department through rulemaking, including amending the Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1) to the mortgagee's title insurance policy, ultimately will provide mortgage lenders affirmative insurance against the risk of loss under a claim of lien invalidity arising solely from the title agent's failure to provide homeowners this notice at least one business day prior to loan closing. This rulemaking process is estimated to require some 3-4 months, however, and mortgage lenders until then should develop interim procedures to satisfy the new constitutional requirement for advance notice of actual fees and charges either by their directly delivering the notice to the homeowners or by arranging for the delivery of the notice by the title agents in the manner outlined.

Enclosed are drafts of supporting documentation our firm will have available for our clients' closing procedures during a transitional period of the next 3-4 months under which title agents agree to provide the advance form of final HUD-1 Settlement Statement to satisfy the new constitutional notice requirement:

1. “Addendum to Closing Instructions from Lender” setting out requirements for assuring compliance with the early disclosure requirements of Section 50(a)(6)(M)(ii). Paragraph 6, of course, assumes that the T-42.1 endorsement will be amended to provide affirmative protections for this risk if these procedures are followed, and would not be included in the Closing Instructions until rulemaking authorizing the amended T-42.1 endorsement were completed;
2. “Owner’s Affidavit Acknowledging Lender’s Compliance with Constitutional Requirement to Provide Owner Early Final Itemized Disclosure of Actual Fees and Charges,” which we have put in affidavit form to underscore its importance to the consumer and hopefully establish prima facie evidence of compliance. The two blanks appearing in paragraphs 2 and 3 would be completed with the dates of the business day immediately preceding the scheduled date of closing and the date of closing, respectively. We have assumed in absence of interpretive rulemaking that the final HUD-1 Settlement Statement as earlier disclosed to the homestead owner(s) cannot vary in any respect, even if a change were beneficial to the owner(s).

We are currently scheduling meetings to counsel each of our clients engaged in home equity lending about the effects of these constitutional amendments on their operations and the appropriate procedures to be followed by them to assure compliance with the new notice requirements. We will be seeking written instructions from each of our clients regarding the procedures each will adopt over the expected transitional period of the next 3-4 months to assure compliance.

Attachments:

- Exhibit A. Promulgated form of “Notice Concerning Extensions of Credit Defined by Section 50(a)(6), Article XVI, Texas Constitution” as of the Effective Date.
- Exhibit B. Draft form of “Addendum to Closing Instructions from Lender” regarding compliance with constitutional requirements applicable to Texas home equity loans to provide homestead owner early final itemized disclosure of actual fees and charges as of the Effective Date.
- Exhibit C. Draft form of “Owner’s Affidavit Acknowledging Lender’s Compliance with Constitutional Requirement to Provide Owner Early Final Itemized Disclosure of Actual Fees and Charges”

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.

EXHIBIT A

NOTICE CONCERNING EXTENSIONS OF CREDIT DEFINED BY SECTION 50(a)(6), ARTICLE XVI, TEXAS CONSTITUTION

SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION ALLOWS CERTAIN LOANS TO BE SECURED AGAINST THE EQUITY IN YOUR HOME. SUCH LOANS ARE COMMONLY KNOWN AS EQUITY LOANS. IF YOU DO NOT REPAY THE LOAN OR IF YOU FAIL TO MEET THE TERMS OF THE LOAN, THE LENDER MAY FORECLOSE AND SELL YOUR HOME. THE CONSTITUTION PROVIDES THAT:

- (A) THE LOAN MUST BE VOLUNTARILY CREATED WITH THE CONSENT OF EACH OWNER OF YOUR HOME AND EACH OWNER'S SPOUSE;
- (B) THE PRINCIPAL LOAN AMOUNT AT THE TIME THE LOAN IS MADE MUST NOT EXCEED AN AMOUNT THAT, WHEN ADDED TO THE PRINCIPAL BALANCES OF ALL OTHER LIENS AGAINST YOUR HOME, IS MORE THAN 80% OF THE FAIR MARKET VALUE OF YOUR HOME;
- (C) THE LOAN MUST BE WITHOUT RECOURSE FOR PERSONAL LIABILITY AGAINST YOU AND YOUR SPOUSE UNLESS YOU OR YOUR SPOUSE OBTAINED THIS EXTENSION OF CREDIT BY ACTUAL FRAUD;
- (D) THE LIEN SECURING THE LOAN MAY BE FORECLOSED UPON ONLY WITH A COURT ORDER;
- (E) FEES AND CHARGES TO MAKE THE LOAN MAY NOT EXCEED 3% OF THE LOAN AMOUNT;
- (F) THE LOAN MAY NOT BE AN OPEN-END ACCOUNT THAT MAY BE DEBITED FROM TIME TO TIME OR UNDER WHICH CREDIT MAY BE EXTENDED FROM TIME TO TIME UNLESS IT IS A HOME EQUITY LINE OF CREDIT;
- (G) YOU MAY PREPAY THE LOAN WITHOUT PENALTY OR CHARGE;
- (H) NO ADDITIONAL COLLATERAL MAY BE SECURITY FOR THE LOAN;
- (I) THE LOAN MAY NOT BE SECURED BY AGRICULTURAL HOMESTEAD PROPERTY, UNLESS THE AGRICULTURAL HOMESTEAD PROPERTY IS USED PRIMARILY FOR THE PRODUCTION OF MILK;
- (J) YOU ARE NOT REQUIRED TO REPAY THE LOAN EARLIER THAN AGREED SOLELY BECAUSE THE FAIR MARKET VALUE OF YOUR HOME DECREASES OR BECAUSE YOU DEFAULT ON ANOTHER LOAN THAT IS NOT SECURED BY YOUR HOME;
- (K) ONLY ONE LOAN DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MAY BE SECURED WITH YOUR HOME AT ANY GIVEN TIME;
- (L) THE LOAN MUST BE SCHEDULED TO BE REPAYED IN PAYMENTS THAT EQUAL OR EXCEED THE AMOUNT OF ACCRUED INTEREST FOR EACH PAYMENT PERIOD;
- (M) THE LOAN MAY NOT CLOSE BEFORE 12 DAYS AFTER YOU SUBMIT A WRITTEN APPLICATION TO THE LENDER OR BEFORE 12 DAYS AFTER YOU RECEIVE THIS NOTICE, WHICHEVER DATE IS LATER; AND IF YOUR HOME WAS SECURITY FOR THE SAME TYPE OF LOAN WITHIN THE PAST YEAR, A NEW LOAN SECURED BY THE SAME PROPERTY MAY NOT CLOSE BEFORE ONE YEAR HAS PASSED FROM THE CLOSING DATE OF THE OTHER LOAN;
- (N) THE LOAN MAY CLOSE ONLY AT THE OFFICE OF THE LENDER, TITLE COMPANY, OR AN ATTORNEY AT LAW;
- (O) THE LENDER MAY CHARGE ANY FIXED OR VARIABLE RATE OF INTEREST AUTHORIZED BY STATUTE;
- (P) ONLY A LAWFULLY AUTHORIZED LENDER MAY MAKE LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION; AND
- (Q) LOANS DESCRIBED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION MUST:
 - (1) NOT REQUIRE YOU TO APPLY THE PROCEEDS TO ANOTHER DEBT EXCEPT A DEBT THAT IS SECURED BY YOUR HOME OR OWED TO ANOTHER LENDER;
 - (2) NOT REQUIRE THAT YOU ASSIGN WAGES AS SECURITY;
 - (3) NOT REQUIRE THAT YOU EXECUTE INSTRUMENTS WHICH HAVE BLANKS LEFT TO BE FILLED IN;

- (4) NOT REQUIRE THAT YOU SIGN A CONFESSION OF JUDGMENT OR POWER OF ATTORNEY TO ANOTHER PERSON TO CONFESS JUDGMENT OR APPEAR IN A LEGAL PROCEEDING ON YOUR BEHALF;
- (5) PROVIDE THAT YOU RECEIVE A COPY OF ALL DOCUMENTS YOU SIGN AT CLOSING;
- (6) PROVIDE THAT THE SECURITY INSTRUMENTS CONTAIN A DISCLOSURE THAT THIS LOAN IS A LOAN DEFINED BY SECTION 50(a)(6), ARTICLE XVI, OF THE TEXAS CONSTITUTION;
- (7) PROVIDE THAT WHEN THE LOAN IS PAID IN FULL, THE LENDER WILL SIGN AND GIVE YOU A RELEASE OF LIEN OR AN ASSIGNMENT OF THE LIEN, WHICHEVER IS APPROPRIATE;
- (8) PROVIDE THAT YOU MAY, WITHIN 3 DAYS AFTER CLOSING, RESCIND THE LOAN WITHOUT PENALTY OR CHARGE;
- (9) PROVIDE THAT YOU AND THE LENDER ACKNOWLEDGE THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LOAN CLOSES; AND
- (10) PROVIDE THAT 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; AND

(R) IF THE LOAN IS A HOME EQUITY LINE OF CREDIT:

- (1) YOU MAY REQUEST ADVANCES, REPAY MONEY, AND REBORROW MONEY UNDER THE LINE OF CREDIT;
- (2) EACH ADVANCE UNDER THE LINE OF CREDIT MUST BE IN AN AMOUNT OF AT LEAST \$4,000;
- (3) YOU MAY NOT USE A CREDIT CARD, DEBIT CARD, SOLICITATION CHECK, OR SIMILAR DEVICE TO OBTAIN ADVANCES UNDER THE LINE OF CREDIT;
- (4) 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;
- (5) THE MAXIMUM PRINCIPAL AMOUNT THAT MAY BE EXTENDED, WHEN ADDED TO ALL OTHER DEBTS SECURED BY YOUR HOME, MAY NOT EXCEED 80 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME ON THE DATE THE LINE OF CREDIT IS ESTABLISHED;
- (6) IF THE PRINCIPAL BALANCE UNDER THE LINE OF CREDIT AT ANY TIME EXCEEDS 50 PERCENT OF THE FAIR MARKET VALUE OF YOUR HOME, AS DETERMINED ON THE DATE THE LINE OF CREDIT IS ESTABLISHED, YOU MAY NOT CONTINUE TO REQUEST ADVANCES UNDER THE LINE OF CREDIT UNTIL THE BALANCE IS LESS THAN 50 PERCENT OF THE FAIR MARKET VALUE; AND
- (7) THE LENDER MAY NOT UNILATERALLY AMEND THE TERMS OF THE LINE OF CREDIT.

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.

THE UNDERSIGNED ACKNOWLEDGE RECEIPT OF THE FOREGOING NOTICE

ON _____, 200_.

Owner/Borrower

Owner/Borrower

Owner/Borrower

Owner/Borrower

EXHIBIT B

ADDENDUM TO CLOSING INSTRUCTIONS FROM LENDER

COMPLIANCE WITH CONSTITUTIONAL REQUIREMENTS APPLICABLE TO TEXAS HOME EQUITY LOANS TO PROVIDE HOMESTEAD OWNER EARLY FINAL ITEMIZED DISCLOSURE OF ACTUAL FEES AND CHARGES

[Section 50(a)(6)(M)(ii), Article XVI, Texas Constitution]

(the "Lender")

THIS ADDENDUM TO CLOSING INSTRUCTIONS FROM LENDER (the "Addendum") supplements and amends the enclosed Closing Instructions from Lender and any other addenda thereto (the "Closing Instructions"). If the instructions contained in this Addendum conflict, or appear to conflict, with the Closing Instructions, this Addendum controls, and you are instructed to follow the instructions set forth in this Addendum. Please call the Lender's designated Closer for this Loan identified in the Closing Instructions if you have any questions or require clarification about your instructions before proceeding with Loan settlement.

SPECIAL INSTRUCTIONS TO SETTLEMENT AGENT

Effective for Texas home equity loan closings occurring on or after _____, 2003, amendments to Section 50(a)(6), Article XVI, Texas Constitution, provide that a home equity loan may not be closed before one business day after the date that the homestead owner receives a final itemized disclosure of the actual fees, points, interest, costs, and charges that will be charged at closing. This Addendum sets forth your instructions regarding procedures you must follow to assure compliance with this constitutional requirement.

1. **Advance Receipt of Final HUD-1.** You must provide, and the owner of the homestead must receive and acknowledge, a copy of the final HUD-1 Settlement Statement itemizing the actual fees, points, interest, and costs that will be charged at closing in connection with this Loan at least one business day before the date of closing of this Loan. For this purpose, "owner of the homestead" means all record title holders of the secured property and their spouses who also occupy the property as their homesteads, regardless of whether the spouses are borrowers obligated to sign the promissory note evidencing the Loan or are record title holders of the homestead property.
2. **Authorized Date of Closing.** You are authorized to close this Loan only on a business day that is at least one business day after the date that you provided each homestead owner a copy of the final HUD-1 Settlement Statement for this Loan itemizing the actual fees, points, interest, and costs that will be charged at closing. For this purpose, a "business day" means any day of the week except Saturday, Sunday, or an official Texas or federal holiday. If the scheduled date of closing for this Loan is not an authorized date of closing, this Loan must be rescheduled for closing on an authorized date of closing.
3. **No Changes in Fees and Charges.** The final HUD-1 Settlement Statement you prepare in connection with the closing of this Loan must be identical to the advance copy of the HUD-1 Settlement Statement you provided the owner of the homestead. You are not authorized to close this Loan if any of the fees, points, interest, and costs itemized on the final HUD-1

Settlement Statement you prepare in connection with this Loan differ in any respect from the fees, points, interest, and costs itemized on the advance copy of the HUD-1 Settlement Statement you provided the owner of the homestead. No changes in the type or amount of any fees, points, interest, and costs itemized in the advance copy of the HUD-1 Settlement Statement you provided the owner of the homestead may be made without the prior written approval of the Lender. If a change is made in the HUD-1 Settlement Statement with the prior written approval of the Lender, you must provide each owner of the homestead a copy of the revised HUD-1 Settlement Statement and reschedule the closing of this Loan for the first or a subsequent business day after the date of receipt of the revised HUD-1 Settlement Statement by the last of the owners of the homestead to receive the revised HUD-1 Settlement Statement.

4. **Affidavit of Compliance.** At closing of this Loan, each owner of the homestead must acknowledge in writing on oath (i) that an advance copy of the HUD-1 Settlement Statement itemizing the actual fees, points, interest, costs, and charges to be charged at closing of this Loan was received by each owner and that the date of closing is at least one business day after the date on which the advance copy of the HUD-1 Settlement Statement was received by each, and (ii) that the amounts of the itemized fees, points, interest, costs, and charges on the final HUD-1 Settlement Statement presented to the owner at closing of this Loan are identical to the amounts for such fees, points, interest, costs, and charges earlier disclosed.
5. **No Waiver or Consent Authorized.** You are not authorized to accept a waiver by the owner of the homestead of the owner's constitutional right to receive an advance disclosure of the actual fees, points, interest, costs and charges that will be charged at closing of this Loan or to accept a written consent by the owner of the homestead to receive such a final itemized disclosure or a modification of such a final itemized disclosure on the date of closing based upon the existence of a claimed bona fide emergency or other good cause.
6. **Issuance of T-42.1 Endorsement.** You must endorse the mortgagee policy issued to Lender in connection with this Loan with the Supplemental Coverage Equity Loan Mortgage Endorsement (T-42.1) insuring the Lender against loss sustained under the terms of the policy because of the invalidity or unenforceability of the insured lien on the homestead property securing this Loan arising solely by reason of your failure to provide the owner of the homestead a copy of the final HUD-1 Settlement Statement itemizing the actual fees, points, interest, costs and charges to be charged at settlement at least one business day before the date that the owner executed the insured mortgage and the promissory note secured thereby.

