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MEMORANDUM

TO: Clients and Friends of the Firm
FROM: Sam J. Brown
DATE: October 23, 2007
SUBJECT: Proposed Constitutional Home Equity Amendments Require Texas Lenders to Provide New 12-Day Notice of Extensions of Credit as Early as November 22, 2007

Texas voters at the general election to be held November 6, 2007, will consider certain amendments to the Texas Constitution proposed by HJR 72, a joint resolution of the 80th Texas Legislature. If approved, these constitutional amendments will be effective on the date of the official canvass of the election returns, which will occur as early as November 22 or as late as December 6, 2007 (the "Effective Date").

The proposed amendments are generally favorable to both mortgage lenders and consumers; however, if approved, mortgage lenders should be aware of: (i) a required amendment of the form of the 12-day Notice of Extensions of Credit; (ii) a requirement of the delivery to the owner both prior to and at closing of a copy of the loan application; (iii) a requirement of the delivery to the owner of a copy of all executed documents signed by the owner at closing; and (iv) a prohibition against the owner signing any instrument in which substantive terms of the agreement are blank.

1. ***Amended 12-Day Notice of Extension of Credit.*** If the proposed amendments are approved, the Section 50(g) Notice Concerning Extensions of Credit Defined by Section 50(a)(6), Article XVI, Texas Constitution that must be given homeowners to commence the 12-day "cooling off" period prior to the closing of a home equity loan will be amended. In such event, 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 12-day hiatus after the Effective Date (or, if later, the date of delivery of the amended notice) in which no Texas home equity loans may be closed. Based upon 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 the January 1, 1998 effective date of Texas Constitution, Article XVI, Section 50(a)(6), 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. Of course, applicants for home equity loans on or after the Effective Date must be given the amended form of 12-Day Notice as well. If the amendments are approved, the content of the 12-Day Notice will be amended in several respects, including, pursuant to the proposed amendment to Section 50(a)(6)(I), clarification that the date of closing is controlling with respect to the determination of whether or not the subject real property is designated for agricultural use, remedying the onerous result to the lender in Marketic v. U.S. Bank Nat'l Ass'n, 436 F. Supp. 2d 842 (N.D. Tex. 2006), in which after making of the home equity loan, the homeowners changed the designated use of the subject property to agricultural. In such federal case, which is non-binding upon Texas courts, the Court held that the property was not subject to foreclosure by the lender because of the change by the owner to agricultural use designation after closing of the loan.

2. ***Delivery of Copy of Loan Application Prior to Loan Closing; Delivery of Copy of Executed Documents and Final Loan Application at Closing.*** If approved, the proposed amendment to Sec. 50(a)(6)(M)(ii) will provide that a home equity loan may not be closed prior to one business day after the date the homeowner receives a copy of the loan application *if not previously provided*. It should be noted that the lender is not required to deliver to the owner an additional copy of the loan application one business day prior to loan closing if the lender has previously complied with such provision, i.e., the prior delivery by the lender to the owner of a copy of the loan application. Further, the proposed amendment to Section 50(a)(6)(Q)(v) will also provide that at the time the extension of credit is made, the homeowner shall receive a copy of the final loan application and all *executed* documents signed by the owner *at closing* related to the extension of credit. Compliance with such provision shall require the lender to deliver to the borrower a copy of the final loan application at closing. Further, as stated above, the proposed amendment to Section 50(a)(6)(Q)(v) clarifies that the copies of the documents to be delivered to the owner at loan closing include only the documents signed by the owner at closing that are related to the extension of credit.
3. ***Prohibition of Owner Signing any Instrument Containing Blanks Relating to Substantive Terms of Agreement.*** The proposed amendment to Section 50(a)(6)(Q)(iii) will clarify that the homeowner may not sign any instrument in which blanks relating to substantive terms of the agreement are left to be completed. Although a blank in any instrument which respect to non-substantive terms would not constitute non-compliance with such constitutional provision, we would suggest that the best practice would be to avoid leaving any blank in Texas home equity loan documentation.
4. ***Emergency Relief from Prohibition of Closing Refinance of Section 50(a)(6) Loan Prior to First Anniversary of Closing Date.*** The proposed amendment to Section 50(a)(6)(M)(iii), which prohibits the closing of a loan transaction under Section 50(a)(6) prior to the first anniversary of the closing date of any other extension of credit under Section 50(a)(6) secured by the same homestead property, except a refinance described by Section 50(a)(Q)(x), provides emergency relief from such prohibition if the owner on oath requests an earlier

closing due to a state of emergency that has been declared by the president of the United States or the governor of Texas as provided by law for the area in which the homestead is located.

A copy of the amended 12-Day Notice that must be given to owners/home equity loan applicants on and after the Effective Date is attached to this memorandum as Exhibit A. Please be advised that, if the amendments are approved, the loan documentation, including loan closing instructions, prepared by our office for Texas home equity loans closing on or after the Effective Date will be revised to comply with such constitutional amendments. On or after the Effective Date, our Texas home equity loan closing packages will also be revised to include both of the following documents:

1. **Owner's Affidavit Acknowledging Lender's Compliance with Constitutional Requirement to Provide Owner a Copy of Loan Application and Early Final Itemized Disclosure of Actual Fees and Charges.** A copy of such form is attached to this memorandum as Exhibit B.
2. **Owner's Affidavit Acknowledging Lender's Compliance with Constitutional Requirement to Provide a Copy of Final Loan Application and All Executed Loan Documents.** A copy of such form is attached to this memorandum as Exhibit C.

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 cover your specific case or circumstances.

Please contact our office if you have any questions or comments regarding this memorandum. In the event of the approval of the proposed amendments, we stand ready to assist your operations in compliance with HJR 72.

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 HOMESTEAD PROPERTY THAT IS DESIGNATED FOR AGRICULTURAL USE AS OF THE DATE OF CLOSING, 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 LOAN APPLICATION TO THE LENDER OR BEFORE 12 DAYS AFTER YOU RECEIVE THIS NOTICE, WHICHEVER DATE IS LATER; AND MAY NOT WITHOUT YOUR CONSENT CLOSE BEFORE ONE BUSINESS DAY AFTER THE DATE ON WHICH YOU RECEIVE A COPY OF YOUR LOAN APPLICATION IF NOT PREVIOUSLY PROVIDED AND A FINAL ITEMIZED DISCLOSURE OF THE ACTUAL FEES, POINTS, INTEREST, COSTS, AND CHARGES THAT WILL BE CHARGED AT CLOSING; 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, UNLESS ON OATH YOU REQUEST AN EARLIER CLOSING DUE TO A DECLARED STATE OF EMERGENCY;
- (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;
- (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 FOR SUBSTANTIVE TERMS OF AGREEMENT 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 YOUR FINAL LOAN APPLICATION AND ALL EXECUTED 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, OR SIMILAR DEVICE, OR PREPRINTED CHECK THAT YOU DID NOT SOLICIT, 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
NOT LESS THAN 12 DAYS PRIOR TO THE DATE HEREOF.**

DATE OF SIGNATURE: ____ [CLOSING DATE] ____

-Owner/Borrower
[BORROWER 1, etc.]

-Owner/Borrower

-Owner/Borrower

-Owner/Borrower

