

# TEXAS REVERSE MORTGAGES

## *Legal, Title and Closing Issues*

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# TEXAS REVERSE MORTGAGES

## *Legal, Title and Closing Issues*

*By J. Alton Alsup*

### **I. INTRODUCTION — THE MAKING OF THE MODERN TEXAS REVERSE MORTGAGE**

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 indebtedness of principal advances and accrued interest during their life times so long as they continue to live in their homes and keep their property tax and insurance payments current. The first reverse mortgage loans in Texas history were funded on January 2, 2001,<sup>1</sup> almost three years to the day after the celebrated home equity loan and its backwards cousin, the reverse mortgage, were authorized by a 1997 amendment to the Texas Constitution (the “1997 Amendment”).<sup>2</sup>

Texas’ population of some 2.2 million seniors, age 65 or older, currently ranks fourth in the nation and is expected to grow in only 20 years to 3.6 million.<sup>3</sup> Two-thirds of Texas’ seniors are thought to own their own homes, mostly debt free, but many lack the resources to adequately maintain the property or comfortably pay the taxes, insurance, and utilities. Ironically, Texas homestead law, intended to protect homeowners, too often prior to 1997 had forced our seniors from their homes when they reluctantly sold them as the only means available to them to reach the equity in their homes needed to defray these and other costs of living and medical care. A reverse mortgage, however, provides an alternative for senior Texas homeowners who do not otherwise qualify for or have the means to repay a home equity loan.

The three years lost between the promise of the enabling 1997 Amendment and the actual availability of reverse mortgages in Texas may have seemed a lifetime to the many senior Texas homeowners who had voted for the new law and eagerly sought reverse mortgage financing to provide the means for them to live out their supposed “golden years” in the comfort and security of their own homes. Sadly, the opportunity loss for lenders and senior homeowners alike might have been avoided if the Texas Legislature in crafting the 1997 Amendment had only considered the realities of the national marketplace for such loans and more closely conformed the terms of its constitutional reverse mortgage to the secondary market requirements of the Department of Housing and Urban Development (HUD). Instead, the 1997 Amendment as written was regarded as fatally flawed by HUD, which insures loans made under its Home Equity Conversion Mortgage (HECM) program, and the Federal National Mortgage Association, or Fannie Mae, which buys the insured HECM loans in the secondary market and sponsors its own competing reverse mortgage product, the Home Keeper.<sup>SM</sup> Together the HECM and Home Keeper<sup>SM</sup> loans account today for over 90% of all reverse mortgages made nationwide.

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<sup>1</sup> The first reverse mortgage loan closed and recorded in Texas is believed to have been made by California-based Financial Freedom Senior Funding Corporation to Mr. & Mrs. Vernon Fuller of Garland, Texas, on December 20, 2000, and funded January 2, 2001. *Texas Mortgage Press*, Vol.5-No.3, March, 2001

<sup>2</sup> H. J. Res. 31, 75th Leg., 1997 Tex.Gen.Laws, amending Tex. Const., art. XVI, § 50, effective January 1, 1998.

<sup>3</sup> *Demographic Profile of the Elderly in Texas*, Texas Department of Aging, March, 2000, accessible at [www.tdoa.state.tx.us/documents](http://www.tdoa.state.tx.us/documents)

HUD and Fannie Mae were particularly concerned about ambiguous provisions of the 1997 Amendment 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.<sup>4</sup> The ability of a lender to accelerate the indebtedness under these conditions is fundamental to the underwriting of risk under eligibility standards for the HECM and Home Keeper<sup>SM</sup> programs nationwide. Because of these and other expressed concerns, HUD would not insure, and Fannie Mae would not purchase, the Texas reverse mortgage as defined by the 1997 Amendment. The orphaned Texas reverse mortgage languished as a result until the occurrence of the milestone events discussed in this article that were responsible for lifting the barriers to an efficient secondary market for the Texas reverse mortgage, viz:

- *The Legislative Fix.* The biennial Texas Legislature in 1999 passed S.J.R.12, which proposed extensive amendments to Section 50, Article XVI, Texas Constitution, (the “1999 Amendment”) to correct the flawed definition of the Texas reverse mortgage complained of by HUD and Fannie Mae and thereby qualify the Texas reverse mortgage for the HECM and Home Keeper<sup>SM</sup> loan programs and general acceptability in the secondary market. The 1999 Amendment was approved by voter referendum on November 4, 1999, and became effective January 1, 2000.
- *The HECM Roll-Out.* On the heels of the 1999 Amendment, HUD first announced in its Mortgagee Letter 00-9 on March 8, 2000, that it would immediately begin insuring reverse mortgages under its HECM program in the State of Texas. Adaptation of standardized HECM program features and legal documentation to unique Texas constitutional requirements proved challenging, however, and revised rulemaking and model forms were to follow in two more releases before the roll-out was complete: Mortgagee Letters 00-34 on August 30, 2000, and 00-39 on November 6, 2000, each amending the prior release and publishing revised model forms of program legal documents.
- *Texas Rulemaking.* Texas procedural rules were 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.

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, as amended by the 1999 Amendment reforming structural deficiencies and the 2005 amendment authorizing line of credit advances for the first time, and HUD’s HECM program as adapted to Texas law and practices. For context, 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 in Section II. Finally, the extent to which reverse mortgage lenders may shift the strict compliance risk to title insurers under Procedural Rule P-45 and the notice and expedited foreclosure procedures under revised Civil Procedure Rules 735 and 736 are briefly examined in Sections III and IV of this article.

## II. BACKGROUND — TEXAS’ UNIQUELY PROTECTIVE HOMESTEAD LAWS

The Texas Constitution establishes and guarantees the right of homestead and, since amended in its modern form in the Convention of 1875, prescribes limitations for mortgaging the homestead that, before the 1997

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<sup>4</sup> Tex. Const., art. XVI, § 50(k)(6)(A)-(D)

Amendment, distinguished Texas as the only state in the nation in which homeowners could not borrow against the built-up equity in their homes.

Adopted at a time when Texas was largely a poor, agrarian society, the state's uniquely protective homestead law is based on public policy considerations and is 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.<sup>5</sup> These same homestead exemption rights were only extended to an unmarried adult person not the head of a household by constitutional amendment as late as 1973. And the homestead exemption concept itself was changed by constitutional amendment in 1983 – repealing the old money-valuation exemption in favor of the modern form in which generally up to ten acres of urban property<sup>6</sup> or 200 acres of rural property, with a dwelling and other improvements thereon, can be protected as a *homestead*.

Texas homestead rights today are derived both from the state's constitution and various state statutes, including its Property Code, enacted to carry out the purposes of the constitutional provisions.<sup>7</sup> Beyond merely exempting the homestead from forced sale by general creditors, however, Texas recognizes homestead rights as being in the nature of an estate in land.<sup>8</sup> 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.<sup>9</sup>

But even with their mutual consent, a homestead may only be encumbered for the limited 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; and, since a 1995 constitutional amendment, for the additional purposes of an owelty of partition (imposed against the entirety of the property by a court order or by written agreement of the partitioning parties) and a refinancing of a lien, including a federal tax lien (resulting from tax debt of the owner or, in the case of a family homestead, both spouses); since the 1997 Amendment, for the additional purposes of an (a)(6) equity loan and an (a)(7) reverse mortgage; and, since a 2001 amendment, for the additional purpose of converting a personal property lien secured on a manufactured home unit to a real property lien on a homestead.

Section 50, Article XVI, Texas Constitution, embodies the constitutional protections of the homestead of a family or a single, adult person from forced sale and, in Section 50 (a)(7), expressly authorizes a reverse mortgage as a type of debt that may be secured by a valid lien against homestead property. A constitutional reverse mortgage is defined in terms of an extension of credit made in conformity with the certain provisions enumerated in Article XVI of the Texas Constitution as Sections 50(k) through (p), inclusive.

This is significant because 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 consti-

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<sup>5</sup> 43 Tex. Jur. 3d, *Homesteads* § 2 (1985); *Thomas v. Creager*, 107 S.W.2d 705 (Tex. Civ. App.—Eastland 1937, writ dismissed w.o.j.)

<sup>6</sup> 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.

<sup>7</sup> 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).

<sup>8</sup> 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)

<sup>9</sup> *U. S. v. Rogers*, 103 S. Ct. 2132 (1983), at 2138-2139, on remand 712 F.2d. 990 (1983)

tution.<sup>10</sup> 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,” furthermore, would appear to dispel any notion that mere *substantial compliance* with these provisions is sufficient to satisfy the conditions to creation of 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),<sup>11</sup> a purported reverse 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 waive none of these conditions because each is constitutionally vested.<sup>12</sup> In any event, a constitutionally deficient lien cannot be estopped into existence,<sup>13</sup> 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.<sup>14</sup>

### III. THE TEXAS REVERSE MORTGAGE DEFINED

#### A. Concept of the Reverse Mortgage — How it Works

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 life times so long as they continue to live in their homes and keep their property tax and insurance payments current. [Sec. 50(a)(7) and 50(k), Art. XVI, Tex. Const.] Reverse mortgages are meant to provide “house rich but cash poor” seniors the resources needed to remain in their homes for the rest of their lives, if they so desire, by converting their home equity into annuity-like periodic payments, or advances, to the homeowners over their remaining lives or, if preferred, a term of years that may be used to pay for housing costs, medical care, and other costs of living.

This equity loan program is called a “reverse mortgage” because payments on the mortgage are said to flow in reverse – from the lender to the homeowner. Unlike a Texas home equity loan in which the homeowner must immediately begin repaying the principal loan amount in substantially equal monthly payments that amortize and fully repay the loan by the maturity date, disbursements made to the homeowner under a reverse mortgage simply accrue interest, including interest on interest, until maturity when the full loan balance of principal and interest is repaid to the lender in one final lump sum payment. A common misconception about reverse mortgages is that the transaction involves the transfer of title of the home to the mortgage lender in exchange for monthly payments. But a reverse mortgage is merely a loan secured by a lien of the homestead — just like the lien of a conventional, or “forward,” mortgage.

A reverse mortgage is tailored to the financial needs of senior homeowners who most often live on a limited or fixed income and may not otherwise qualify to repay a home equity or conventional mortgage loan. Before reverse mortgages first became widely available to Texas homeowners in 2001, seniors too

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<sup>10</sup> *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)

<sup>11</sup> *Matter of Henderson*, 18 F.3d 1305 (5th Cir. 1994, certiorari denied)

<sup>12</sup> *Englander Co. v. Kennedy*, 424 S.W.2d 305 (Tex. Civ. App. – Dallas 1968, writ ref’d n.r.e.)

<sup>13</sup> See *Hruska v. First State Bank of Deanville*, 747 S.W.2d 783 (Tex. 1988)

<sup>14</sup> *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*

often were forced to sell and move from their homes in order to reach the cash equity in their homes needed to defray living costs. But there are no income or credit history requirements for eligibility for a reverse mortgage. Senior homeowners are not required to demonstrate general creditworthiness or to have a source of income or assets with which to repay the loan. And homeowners are eligible regardless of their advanced age or condition of their health.

Any Texas resident age 62, or older, who owns and occupies as a principal dwelling a single family home, a qualified condominium unit or townhouse, or a permanently attached and qualified manufactured home, in which there is sufficient appraised home equity (i.e., appraised market value minus the current balance of all mortgages and liens secured on homestead property = equity) should qualify for a reverse mortgage. If the homeowner is married, both spouses in title must be age 62, or older, to qualify for an FHA-insured Home Equity Conversion Mortgage (HECM), the most popular currently available reverse mortgage program, and all loan applicants must first have completed mandatory counseling by an approved non-profit counseling agency on the risks and benefits of a reverse mortgage and alternative financing options.

Proceeds from a reverse mortgage may be used by senior homeowners for any purpose, although most often loan proceeds are regarded as a supplement to Social Security benefits and pension payments and used by homeowners to maintain their homes in a good state of repair, pay property taxes and insurance when due, and defray medical and other ordinary costs of living during their Golden Years. Significantly, advances under a reverse mortgage are not taxable as income and generally do not affect senior homeowners' eligibility for Social Security or Medicare benefits. (However, senior homeowners electing a lump-sum advance of proceeds should seek counseling regarding their continued eligibility for Medicaid benefits if retaining the advance as a liquid asset.)

The maximum loan amount under a reverse mortgage for which a homeowner may qualify is calculated according to underwriting guidelines based upon a number of variable factors, including the age of the homeowner (or, if married, the age of the younger of the spouses), the method of optional advances the homeowner chooses (i.e., lump-sum, line of credit, term, or tenure), the appraised value of the home and home equity, and current interest rates. Assuming all other factors are equal, for example, a 62-year old homeowner choosing to receive monthly payments for the rest of his life (based on actuarial life expectancy) will receive less per month than an 82-year old choosing to receive monthly payments over a stated term of eight years. As calculated, the approved maximum principal limit that may be advanced under a reverse mortgage, when added to projected accrued interest and other borrowing costs over the loan term, should not exceed the projected fair market value of the home securing the loan at the time of maturity. Maximum advances under a reverse mortgage, therefore, generally will be less than available under a Texas home equity loan and most often will not exceed 50% of appraised home equity value as of the date of closing. Maximum loan limits for HUD's HECM reverse mortgage loan program currently are set at \$200,160 (or as high as \$362,790 in certain "high cost" areas) and for Fannie Mae's Homekeeper® reverse mortgage loan program up to \$417,000.

Closing costs are similar but comparatively higher than imposed for a conventional mortgage. FHA-insured HECM program reverse mortgages, for example, which account for 90% of all reverse mortgages currently made nationwide, provide for a 2% loan origination fee payable to the mortgage lender, an upfront 2% FHA mortgage insurance premium (MIP) and a continuing annual .50% MIP premium factored into the monthly interest rate, and servicing fees of \$35 per month set aside for payment to the loan servicer over the term of the loan. Other fees and charges for property appraisal and survey, credit report, flood certification, pest inspection, title insurance, document preparation, escrow, courier and recording fees are comparable to other mortgage loans.

A reverse mortgage is a non-recourse loan 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.

Under Texas law, the loan balance of a reverse mortgage generally cannot be called due and payable until and unless the homeowner (i) sells or transfers the homestead property, (ii) permanently abandons the property for 12 consecutive months without obtaining the lender's prior approval, or (iii) dies (or, if married, the last of the homeowners dies). However, the lender in some cases may call the loan due if discovering the homeowner has committed actual fraud in connection with the loan or has defaulted on contractual obligations in the deed of trust to repair and maintain, pay taxes and assessments on, or insure the homestead property, or has failed to maintain the lender's first-lien priority 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 even make application for a reverse mortgage. If intending to foreclose for any reason, a lender must first give written notice to the homeowner that a ground for foreclosure exists and give the homeowner an opportunity to cure the ground for foreclosure. Finally, 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 discussed in this article. [Rules 735 and 736 RCP]

## **B. The 1999 Amendment — Reform Legislation to Cure the 1997 Definitional Deficiencies**

The Texas Legislature crafted the 1999 Amendment to cure critical deficiencies in the 1997 Amendment and define a Texas reverse mortgage in more traditional terms acceptable to the secondary mortgage market. Specifically, the 1999 Amendment, effective January 1, 2000,<sup>15</sup> amended Subsections (k), (p), and (r) of Section 50, Article XVI, Texas Constitution, to provide for the following amended terms:

- 1. Increased Eligibility Age.** Subsection (k)(2) was amended to raise the eligibility age of homeowners for a reverse mortgage from age 55, established by the 1997 Amendment, to conform to the national industry standard of 62 years, or older. A Texas reverse mortgage may now be made only "to a person who is, *or whose spouse is*, 62 years or older."
- 2. Borrower's Death as Maturity Event.** New Subsection (k)(6)(A) was added to provide expressly that the lender may require repayment of the debt when "all borrowers have died", a standard maturity event that was inexplicably omitted from the 1997 Amendment. Since the lender under the 1997 Amendment could require repayment of the debt when the homestead property securing the reverse mortgage loan was sold *or otherwise transferred*, however, it was generally thought prior to the 1999 Amendment that the lender would have to rely on the death of the last of the homeowners to die as constituting a *transfer* of the homestead property by testamentary gift or by the laws of descent and distribution in order to mature the debt upon the borrower's death.

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<sup>15</sup> H. J. Res. 12, 76th Leg., 1999 Tex. Gen. Laws

3. **Borrower's Vacating Premises as Maturity Event.** Old Subsection (k)(6)(B) was amended and renumbered as (k)(6)(C) to provide expressly that the lender may require repayment of the debt when "all borrowers cease occupying the homestead property for a period of longer than 12 consecutive months without prior written approval of the lender." This provision is a substantive amendment of an ambiguous standard under the 1997 Amendment that permitted the lender to mature the debt only "when all borrowers cease occupying the home for more than 180 days and the location of the homestead property owner is unknown to the lender." HUD and Fannie Mae were concerned under the 1997 Amendment provision that, even if the homestead property were permanently abandoned, the lender would be constrained from maturing the debt in any case in which the lender knew of the location of the homeowner, who then may be living with relatives or in a retirement home, or could determine the homeowner's location upon reasonable inquiry.
4. **Breach of Covenants as Events of Default.** New Subsection (k)(6)(D) was added to provide for the authority of the lender to require repayment of the debt in the event of certain enumerated defaults generally conforming to national industry standards, including if the borrower (i) defaults on an obligation 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 by promptly discharging any superior lien within 10 days after receiving notice from the lender (subject to certain rights of the borrower to contest the purported superior lien in good faith or otherwise resolve the matter to the satisfaction of the lender as described in subsection C. 4. of this section).
5. **Forfeiture Conditioned on Notice and Opportunity to Cure.** Subsection (k)(7) was amended to require that the borrower first provide the lender notice of a claimed default, and an opportunity for the lender to cure the default after that notice, before the Draconian constitutional forfeiture provisions of that subsection may be invoked. A lender is now subject to the threat of forfeiture of all principal and interest of a reverse mortgage if failing to make loan advances to the borrower as required in the loan documents *only* if the lender fails to cure the default as required in the loan documents after notice from the borrower.

Subsection (k)(7) was also amended to effectively exempt HUD, or its Federal Housing Administration (FHA), from the applicability of this forfeiture provision when taking an assignment of a reverse mortgage in order to cure the default, as that governmental agency may routinely do when performing under its insurance obligation on HECM loans. This forfeiture subsection now does not apply when a governmental agency or instrumentality takes an assignment of a reverse mortgage loan in order to cure the default. Presumably, Fannie Mae, officially a government-sponsored enterprise (GSE), would also have the protections of this exemption if regarded to be a government *instrumentality*, as that term is commonly understood.

6. **New Consumer Disclosures Regarding Acceleration and Foreclosure.** New Subsection (k)(9) was added to require the lender of a reverse mortgage loan to disclose to the borrower by written notice given at loan closing the specific provisions enumerated in Subsection (k)(6) under which the borrower is required to repay the loan. Subsection (k)(6), as amended by the 1999 Amendment, enumerates the complete and exclusive grounds for which a lender of a reverse mortgage loan may accelerate the debt and require repayment of the loan.

New Subsection (k)(10) also was added to require the lender of a reverse mortgage before commencing foreclosure to disclose to the borrower that a ground for foreclosure exists and

to give the borrower at least 30 days (or at least 20 days if the ground is the failure of the borrower to maintain lien priority of the reverse mortgage) to remedy the condition creating the ground for foreclosure, pay the debt from proceeds of the sale of the homestead property or from other sources, or convey the homestead property to the lender by deed in lieu of foreclosure. Notice must be given to the borrower in the same manner provided for notice by mail related to foreclosure of home equity liens under Section 50(a)(6).

7. **Requirement that Advances be Made at Regular Intervals Modified.** Subsection (p) was amended to provide for some flexibility in the requirements of that subsection that advances on a reverse mortgage be made at *regular intervals*. Under the 1997 Amendment, if more than one advance was to be made on a reverse mortgage, the advances had to be made at regular intervals according to a plan set out in the original loan agreement. This provision was widely construed as prohibiting “line-of-credit” terms popular in other states that permit the borrower to draw advances only in the amounts needed, if and when needed. Lenders were particularly concerned that the “regular intervals” restriction could preclude a lender from advancing amounts necessary to protect its security interest in the homestead property under terms of standardized loan documents, such as advances made by lenders from time to time to pay delinquent taxes and assessments, lapsed casualty insurance premiums, emergency repair and maintenance costs, or liens attaining priority over the reverse mortgage. As amended, Subsection (p) provided the following additional flexibility in the “regular intervals” requirement:

- The agreed loan terms for the method of making advances are no longer restricted to the *original* loan documents, clarifying that the parties are not precluded from amending the original terms by a subsequent loan modification agreement.
- The agreed loan terms may include advances made at regular intervals in which the amounts advanced may be reduced, for one or more advances, at the request of the borrower. Presumably, this method would permit the borrower to request that any advance be reduced to as little as zero for a single month or for the balance of the loan term.
- The agreed loan terms may include advances made *at any time* by the lender, on behalf of the borrower, to the extent necessary to protect the lender’s interest in, or the value of, the homestead property, to pay taxes, insurance, costs of repairs and maintenance costs (when performed by other than an employee or affiliated entity of the lender), assessments, and any lien that has or may attain priority over the reverse mortgage if the borrower fails to timely pay any of those charges in accordance with the borrower’s obligation under the loan documents.

Moreover, note that Subsection (p) was subsequently amended by the 2005 Amendment, effective November 23, 2005, to authorize line of credit advances under a Texas reverse mortgage. (S.J.R. 7, 79<sup>th</sup> Tex. Leg. 2005) as discussed in subsection C. 6. of this Section III.

8. **New Expedited Foreclosure Rules Promulgated.** Subsection (r) was amended to require 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. In that regard, new Subsection (k)(11) was added to provide 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). The Supreme Court accordingly has adopted revised Rules 735 and 736, Rules of Civil Procedure, for this purpose, as discussed in Section IV.B. of this article.

### C. The Modern Reverse Mortgage Defined

The Texas reverse mortgage is a creation of our state constitution, and all Texas law establishing and regulating the reverse mortgage, in fact, is contained in the comparatively brief provisions of Section 50, Article XVI, of the Texas Constitution, as amended by 1999 and 2005 amendments. These provisions include 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, 78<sup>th</sup> Tex. Leg. 2003)

Prior to the 2005 Amendment, Section 50(p) authorized advances under a reverse mortgage to be made to elder homeowners only in a single advance at loan settlement or “at regular intervals.” This limiting language was generally construed to prohibit line of credit advances and to require advances after loan settlement to be made in regular periodic advances of predetermined equal amounts over an agreed term of years or the borrowers’ remaining lifetimes. But many elder homeowners desired the flexibility of line of credit terms to allow them to better control the extent of their borrowings and compounding interest costs by electing to request advances only when needed, and in amounts needed, to pay property taxes and insurance, medical bills, or other of life’s necessities. Senate Joint Resolution 7 proposing the Proposition 7 Amendment to authorize line of credit advances under a reverse mortgage was enacted in response to this voiced complaint. Specifically, the Proposition 7 Amendment, effective November 23, 2005, amended Section 50(p) to authorize a line of credit method of advances in which borrowers under a reverse mortgage may elect to draw:

“(4) an initial advance at any time, future advances at times and in amounts requested by the borrower until the credit limit established by the loan documents is reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance is repaid;”

Although the Texas reverse mortgage may be thought of as a particular type of home equity loan, it is important to understand 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 troubling limitations 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 presumably must be strictly observed to be assured of creating a valid and enforceable lien on a homestead property. These defining elements of Section 50, as amended by 1999 and 2005 amendments, 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 appli-

cant 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.

2. ***Non-recourse Debt.*** A reverse mortgage is non-recourse debt and must be made without recourse for personal liability against any owner or the spouse of any owner. A reverse mortgage is typically repaid from sales proceeds upon the sale of the homestead property by the borrower or the sale by the borrower's estate after the borrower, or the last of the borrowers, dies. If a reverse mortgage is not paid when due, the lender or noteholder must look only to recovery against the homestead property under its security interest as its exclusive remedy. The homeowner, therefore, will never owe more than the loan balance or the value of the homestead property, whichever is less, and no assets other than the homestead property may be used to repay the debt. 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 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 un-disbursed 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 due (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. 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. The content, timing, and manner of delivery of the notice and the constitutionally permitted grounds and methods for foreclosure are described in this section IV.
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 in-

cluded 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, 79<sup>th</sup> 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.

#### **D. HUD’s Texas Home Equity Conversion Mortgage (HECM) Program**

##### **1. Background: HUD Rolls-Out its Texas HECM Program**

The Federal Housing Commissioner first announced the immediate availability of Home Equity Conversion Mortgages in Texas in HUD Mortgagee Letter ML 00-9 on March 8, 2000, but it was eight months and two mortgagee letters later before required Texas modifications to the national HECM loan program were finally settled upon and the final form of model loan documents authorized. According to the Commissioner when first announcing the availability of the Texas HECM program in March, 2000, the 1999 Amendment to the Texas Constitution enabled FHA, with only minor modifications to the FHA HECM program described in the announcement, to insure Texas HECM loans without additional risk to the FHA insurance fund. Those modifications basically stemmed from two particular restrictions of the Texas Constitution: (i) its limitations on permitted grounds for acceleration of reverse mortgage debt; and (ii) its then prohibition of line of credit advances under a reverse mortgage.

To address these non-conforming terms, modifications to the HECM program applicable to Texas loans only were originally announced in Mortgagee Letter 00-9, but updated and modified in two subsequent releases: Mortgagee Letter 00-34 on August 30, 2000, and Mortgagee Letter 00-39 on November 6, 2000. HUD's approach was to incorporate all required differences between the Texas HECM program and the terms of HECM programs in other jurisdictions in the model forms of loan documents authorized by HUD for the Texas program. Model forms set out in full and attached to Mortgagee Letter 00-39 replaced earlier versions of Texas model forms published in Mortgagee Letters 00-09 and 00-34 and then constituted the only forms approved for use by HUD to document a HECM loan in Texas. These model forms included Texas forms of a Home Equity Conversion Loan Agreement, Adjustable Rate Deed of Trust, Adjustable Rate Note, Adjustable Rate Second Deed of Trust, Adjustable Rate Second Note, and Repair Rider. However, with the adoption of the 2005 constitutional amendment authorizing line of credit advances under a Texas reverse mortgage loan, HUD has chosen not to publish revised model forms and instead has imposed on approved mortgagees the obligation to adapt all forms to ensure compliance with FHA requirements and the Texas Constitution and statutes. These requirements are set forth in its Mortgagee Letter 2006-06<sup>16</sup> issued March 17, 2006, which authorizes Texas borrowers to choose a line of credit payment option, a modified tenure option (i.e., combination of tenure and line of credit payment options), or a modified term option (i.e., combination of term and line of credit payment options) and provides guidance regarding such matters as the adaptation and preparation of the form of loan documents, including the Repair Rider, the timing of loan closings and disbursements by the lender, the conditions under which the loan may be accelerated under applicable Texas law, and procedures to be followed under Texas law to conduct foreclosures. ML 2006-06 expressly replaces guidance previously issued in ML 00-09, ML 00-34 and ML 00-39 on the same topics.

## 2. Description of HECM Program

**a. Authority.** The Housing and Community Development Act of 1987<sup>17</sup> established the federal mortgage insurance program, Sec. 255 of the National Housing Act, to insure home equity conversion mortgages under the HECM program, which is administered by the Department of Housing and Urban Development (HUD). Originally authorized to insure only 2,500 HECMs, the authority was increased to 50,000 HECMs in 1996 and again to 150,000 HECMs in 1999, when the HECM program was converted from a demonstration to a permanent program,<sup>18</sup> and most recently to 250,000 HECMs in 2005. A provision of H. R. 5121, introduced April 6, 2006 and now pending in Congress, would in part amend the National Housing Act to eliminate the limitation placed upon the aggregate number of HECM loans insured under the Act.

**b. Overview.** General eligibility for a HECM mortgage is restricted to persons (i) who are 62 years of age, or older (i.e., if more than one, the youngest of the borrowers must be at least 62 on the date of applica-

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<sup>16</sup> Copies of ML 2006-06 and the MLs 00-9, 00-34, and 00-39 it replaced may be accessed at [www.hudclips.org/](http://www.hudclips.org/). HUD also published a Proposed Rule August 5, 2005 (70 Fed. Reg. 45498) to amend its HECM insurance program (24 CFR 206.17) to accommodate any state law that may prohibit the line-of-credit advance option generally available to HECM mortgagors by allowing mortgagors residing in any such state to change payment (i.e., advance) options between tenure and term options. However, this guidance appears moot with the adoption of the 2005 amendment to the Texas Constitution authorizing line of credit terms.

<sup>17</sup> P.L. 100-242, February 5, 1986

<sup>18</sup> The Home Equity Conversion Mortgage (HECM) program in Texas is regulated by HUD Handbook 4235.1 Rev-1, dated November 18, 1994, as supplemented and amended by HUD Mortgagee Letters ML 96-15, dated April 10, 1996; ML 97-15, dated April 24, 1997; ML 98-02, dated January 7, 1998; ML 98-25, dated September 21, 1998; ML 99-02, dated February 18, 1999; and ML 00-9 and ML 00-10, each dated March 8, 2000; ML 00-34, dated August 30, 2000 (supplementing ML 00-9); ML 00-39, dated November 6, 2000 (supplementing ML 00-9, ML 00-10 and ML 00-34); and ML 2006-06 dated March 17, 2006 (in part replacing the guidance set out in MLs 00-09, 00-34, and 00-39). Regulations for the HECM program are codified in 24 C.F.R. Part 206. Handbook 4165.1 REV 1, CHG 3, contains further instructions for use of all HUD's single-family insurance programs.

tion)<sup>19</sup>; (ii) who own a one-unit dwelling, which the borrower, or if more than one, at least one of the borrowers occupies as a principal residence (or a 2-4 unit dwelling in which one of the units is so occupied) free and clear of encumbrances (or with liens that may be paid off with the initial disbursement of HECM proceeds or that may be subordinated to the HECM mortgage); and (iii) who have received required counseling regarding reverse mortgages from a HUD-approved counseling agency.

HECM loan proceeds are paid out in advances to the borrower according to a written Payment Plan and are repaid in a single payment from proceeds of the sale of the property after the death of the borrower (or after the death of the last of the borrowers to die) or when the borrower (or any borrower) no longer occupies the property as a principal residence. The HECM is a “non-recourse” loan for which the borrowers will never owe more than the lesser of the loan balance or the value of the property, and no assets of the borrower other than the property may be used to repay the debt.

A HECM mortgage has neither a fixed maturity date nor a fixed mortgage amount. The maximum loan amount, called the Principal Limit, is calculated at loan origination based upon the age of the youngest borrower, the Expected Average Mortgage Interest Rate, and the Maximum Claim Amount, and increases each month in the amount of interest accruals and mortgage insurance premium (MIP) remittances to FHA. The balance of the HECM loan at any time is the sum of advances made to the borrower or on borrower’s behalf, accrued interest thereon (including interest on interest), and insurance premiums paid FHA on the borrower’s behalf.

A HECM mortgage is secured by a first mortgage payable to the lender and a second mortgage payable to FHA. The second mortgage is funded against only if FHA under its insurance obligation has taken an assignment of the loan or otherwise is required to advance payments to the borrower, or to third parties, such as taxing authorities on the borrower’s behalf, and does not have an effective assignment of the first mortgage. The HECM second mortgage typically is not required if the loan after origination is to be sold and assigned to Fannie Mae. Under its mortgage insurance obligation, HUD will assume responsibility for making payments to the borrower, if the lender defaults in that obligation, until the lender is able to resume payments, or for the remainder of the mortgage.

**c. Principal Limit.** The maximum amount the borrower may receive under a HECM mortgage is determined by calculating the “Principal Limit” at loan origination. The Principal Limit at origination is based on the age of the youngest borrower, the “Expected Average Mortgage Rate” or “Expected Rate,” and the “Maximum Claim Amount.” The result of this calculation is increased each month by 1/12th of the sum of the mortgage interest rate in effect at that time and the annual FHA mortgage insurance premium rate of 0.5%. The Expected Rate for a fixed-rate loan is the actual fixed rate of interest in effect at origination and for an adjustable-rate loan it is the sum of the lender’s margin plus the index for the U.S. Treasury Securities rate adjusted to a constant maturity of ten years. The Principal Limit cannot exceed the Maximum Claim Amount, which is the *lesser* of the appraised value of the secured property or the maximum FHA mortgage amount for a one-family residence (under Section 203(b)(2) of the National Housing Act).

**d. Payment Plan.** Generally, the borrower may receive advances of HECM loan proceeds through any one of five basic payment plans: (i) a “Tenure” plan under which the borrower receives equal monthly payments for as long as the borrower is alive and continues to occupy the property as a principal residence; (ii) a “Term” plan under which the borrower receives equal monthly payments from the lender for a fixed period of months selected by the borrower; (iii) a “Line of Credit” plan under which the borrower receives loan proceeds in unscheduled payments or installments, at times and in amounts of the borrower’s choosing, until the line of credit is exhausted; and (iv)(v) “Modified Tenure” and “Modified Term” plans under which a line

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<sup>19</sup> This eligibility requirement differs from the Texas constitutional requirement, § 50(k)(2), Art. XVI, Tex. Const., which requires only that a reverse mortgage be made “to a person who is or whose spouse is 62 years or older”.

of credit feature is combined with a Tenure or Term plan. However, borrowers are permitted under HECM regulations, upon request, to change payment plans, from one option to another throughout the life of the loan and to receive unscheduled payments, suspend payments, or receive the entire Principal Limit in a lump sum payment.

**e. Interest Rate/Shared Appreciation.** Interest under a HECM mortgage may accrue at a fixed or adjustable rate as negotiated between the lender and the borrower, but the borrower may *not* convert from one interest rate plan to another after loan closing. Interest accrues daily and is added to the outstanding loan balance monthly. For adjustable-rate mortgages, the interest rate is initially set and periodically adjusted to equal an index plus a margin. The index is the U.S. Treasury Securities rate adjusted to a constant maturity of one year and the margin is the same margin used to calculate the Expected Rate described in subsection c. above. The lender *must* offer an ARM program that calls for a rate that adjusts annually, with a 2% annual cap and a 5% lifetime cap, but may additionally offer a monthly adjustable ARM program, with only a lifetime cap rate established by the lender.

Generally, HECM mortgage lenders may offer “shared appreciation” terms under any Payment Plan. “Shared Appreciation” terms entitle the borrower to a lower interest rate (with resulting higher monthly payments to the borrower) in consideration for the payment to the lender of a percentage of the appreciation in value of the property, in addition to the outstanding balance, when the HECM mortgage is due and payable. Lenders offering “Shared Appreciation” mortgages must also offer comparable HECM mortgages without shared appreciation terms and must elect to share the risk of loss with FHA under the “shared premium” FHA insurance option described in Subsection f. below. Although shared appreciation terms are permitted by the Texas Constitution and are technically available in Texas, no secondary market has been developed for them and lenders would necessarily be forced to retain shared appreciation loans in portfolio or make arrangements to sell them as correspondents to particular investors.

**f. Mortgage Insurance Premium.** Under the HECM program, the borrower is charged a mortgage insurance premium (“MIP”) for FHA mortgage insurance to reduce the risk of loss should the outstanding balance of the HECM mortgage loan (including principal advances, accrued interest, MIP, and fees) exceed the value of the property at the time the mortgage is due and payable. The MIP consists of a one-time, non-refundable premium equal to 2% of the maximum claim amount that is payable at loan closing and a monthly premium payable for the life of the loan in an amount equal  $1/12^{\text{th}}$  of the annual rate of 0.5% of the outstanding loan balance.

**g. Mortgage Insurance Options.** HECM lenders must choose between two insurance options at loan closing: (1) an “assignment” option in which the lender will have the right to assign the mortgage to HUD when the outstanding balance of the loan is equal to, or greater than, 98% of the Maximum Claim Amount and to receive insurance benefits at the time; or (2) a “Shared Premium” option in which the lender holds the loan for its entire term and retains a portion of the monthly MIP. Under this option, if the outstanding loan balance exceeds the property value at the time the mortgage is due and payable, the lender is paid insurance benefits up to the maximum claim amount and must compensate for any losses with reserves derived from the retained MIP.

**h. Lender and Third-Party Fees.** The borrower under a HECM loan may be charged only reasonable and *bona fide* fees of third-party settlement service providers of the types enumerated and described in Chapter 6-13, Handbook 4235.1 REV-1. HECM lenders additionally may charge the borrower an origination fee agreed upon by the borrower and lender that does not exceed the greater of \$2,000 or two percent of the maximum claim amount of the HECM reverse mortgage, which amount must cover any fee payable to a mortgage broker or loan correspondent. (The borrower is not permitted to pay any additional origination fees of any kind to a mortgage broker or loan correspondent.) All such closing costs, including third-party

fees and charges and the lender's origination fee, may be paid from proceeds of the initial loan advance to the borrower.<sup>20</sup>

**i. Servicing Fees.** A HECM lender is permitted to charge a monthly servicing fee for loan administration services over the life of the loan if the fee has not already been priced into the borrower's mortgage interest rate. The servicing fee in that case is established at loan closing as a flat monthly figure and the aggregate amount estimated to be necessary to pay the fee generally over the life of the loan is set aside from the Principal Limit at closing. The monthly servicing fee may not exceed a range of \$30-35, except in the case of servicing fees for monthly adjustable rate loans for which there is no maximum fee, or cap.

**j. Documenting and Closing of HECM.** The Texas HECM core documents consist of the forms of Adjustable-Rate Note, Deed of Trust, a Home Equity Conversion Loan Agreement, an Adjustable-Rate Second Note, and Second Deed of Trust and, as applicable, forms of riders to the deed of trust, including the Repair Rider, Planned Unit Development Rider, Condominium Rider, and Shared Appreciation Rider.<sup>21</sup> FHA emphasizes that these model forms must be adapted to Texas law and lenders are advised to employ counsel to make any necessary changes to the model instruments to conform them to Texas law. The lender and its counsel must prepare all necessary legal instruments to comply with HUD regulations and applicable federal and state law to document any HECM loan.<sup>22</sup> HECM lenders must provide copies of the forms of the first mortgage note and security instrument to be used in the loan transaction for the borrower's review during the application process, but not later than the time when the borrower signs the formal loan application (the "URLA"). A form of the Home Equity Conversion Mortgage Loan Agreement must also be provided for the borrower's review during the application process, and the completed HUD-1 Settlement Statement must be provided for the borrower's inspection at least one business day before loan closing. Written certifications are required of both the preparer and the borrower of the truth and accuracy of the HUD-1 Settlement Statement and the receipts and disbursements shown thereon.<sup>23</sup> After closing, a closing certification by an officer or other authorized signatory of the lender also is required to the effect that the HECM loan was closed in accordance with the statutory and regulatory requirements of the National Housing Act and HUD.<sup>24</sup> The HUD-1 Settlement Statement must reflect that only third-party fees and charges authorized by Chapter 6 of the Handbook 4235.1 Rev-1 were imposed on the borrower. Required documents that must be submitted by lenders to obtain FHA endorsement for mortgage insurance are enumerated in Chapter 6 of the Handbook 4235.1 Rev-1, and, upon its endorsement, HUD then executes the Home Equity Conversion Mortgage Loan Agreement and re-

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<sup>20</sup> HUD Mortgagee Letters 00-10 dated March 8, 2000 and 2006-07 dated March 27, 2006

<sup>21</sup> Model Texas forms were set out as attachments to HUD Mortgagee Letter 00-39, November 6, 2000, with such adaptations by counsel as may be necessary to conform the instruments to state or local requirements. When adapting these model forms to Texas law and practices, counsel must consult the footnotes to each model form regarding state-specific modifications, instructions in Chapter 6 to Handbook 4235.1 Rev-3, Handbook 4165.1 Rev-1 Chg-3, issued November 30, 1995, regarding Model Mortgage and Note Forms, ML 97-15, ML 00-9 regarding Texas modifications of the form of Loan Agreement and Repair Rider, and ML 2006-06 regarding line of credit terms and other provisions of the 2005 constitutional amendment.

<sup>22</sup> In addition to other disclosures required under the Truth in Lending Act, the lender in a reverse mortgage is required to provide the borrower written disclosures under §226.23, Regulation Z, [24 C.F.R. Part 226] of the total annual loan cost of credit in the form of Appendix K, paragraph (d) of those regulations. Generally referred to as the *Total Annual Loan Cost Rate Disclosure*, or "TALC," this disclosure contains (1) *Notice*. A statement that the borrower is not obligated to complete the transaction merely because the borrower has received the disclosures or has signed an application for a reverse mortgage loan; and (2) a good faith projection of the total cost of the credit expressed as a table of "Total Annual Loan Costs Rates," using that term, that reflects (a) costs and charges to the borrower, (b) payments (advances) to, or for the benefit of, the borrower; (c) additional compensation to the lender (such as "shared appreciation" the lender is entitled to receive); (d) any limitations on the borrower's liability (such as non-recourse limits); (e) assumed appreciation rates for the dwelling securing the loan at rates of 0%, 4%, and 8%, respectively; and (f) and assumed loan periods of 2 years; the actuarial life expectancy of the borrower (or youngest of the borrowers); and that same life expectancy multiplied by a factor of 1.4 and rounded to the nearest full year (and, at the option of the borrower, that same actuarial life expectancy multiplied by a factor of .5 and rounded to the nearest full year).

<sup>23</sup> Ch. 6-9, HUD Handbook 4235.1 Rev-1

<sup>24</sup> Ch. 6-11, HUD Handbook 4235.1 Rev-1

turns a counterpart of the original agreement directly to each of the borrowers and lender, together with a notice to the borrower explaining the procedures to be followed in the event that the lender should ever be late in, or fail to make, required payments to the borrower under the Loan Agreement.

**k. Repayment of HECM.** Under the terms of a HECM mortgage, the borrower may occupy the property and has no repayment obligation until the HECM becomes due and payable, which generally occurs only when the borrower dies, the borrower sells or transfers the property, the borrower ceases occupying the property as a principal residence, the borrower does not occupy the property for 12 consecutive months for health reasons, or the borrower defaults on certain mortgage covenants. When the HECM becomes due and payable, the outstanding balance is normally repaid from proceeds of the sale of the property by the borrower or the borrower's estate. Since a HECM mortgage is a non-recourse loan, the lender's recovery is limited to the value of the property, and there may be no deficiency judgment sought against the borrower or the estate. If the proceeds from the sale of the property are insufficient to pay off the outstanding balance, the lender may recover under a mortgage insurance claim for the amount of difference between the sale proceeds and the outstanding loan balance, up to the maximum claim amount. In Texas, however, the reasons for which a lender may accelerate the debt of a reverse mortgage are strictly limited to express provisions of the Texas Constitution,<sup>25</sup> which are described in subsection III.C.4. of this article and the precise language of which is incorporated into the model forms of Texas HECM loan documents. Accordingly, HUD has announced that it will not grant permission to lenders to accelerate the debt of a Texas HECM reverse mortgage loan for reasons permitted in other jurisdictions of (i) non-occupancy, until the homeowners have failed to occupy the property for more than 12 consecutive months, or (ii) the homeowner's refusal to allow the lender to inspect the property.

### **3. HUD and Fannie Mae Authorize New Line of Credit Option for Texas Reverse Mortgages**

The 2005 Amendment<sup>26</sup> reforms and normalizes Texas law defining and regulating Texas reverse mortgages in several important respects that may not be immediately apparent. Amended Section 50(p), Article XVI, of the Texas Constitution, by expressly authorizing line of credit terms consistent with the terms currently offered under the multistate Home Keeper<sup>®</sup> and HECM reverse mortgage loan programs, enabled Fannie Mae and HUD to immediately begin to offer line of credit, modified term, and modified tenure payment plans in Texas. Moreover, variant policies HUD and Fannie Mae had adopted in 2000 in an effort to comply with the Texas constitutional requirement that advances after loan settlement be made only "at regular intervals" have now been withdrawn.

Section 50(p), as amended, expressly authorizes a reverse mortgage to be funded by "an initial advance at any time" and rendered obsolete HUD's and Fannie Mae's policies of permitting initial disbursement under Texas Home Equity Conversion Mortgage (HECM) and Texas Home Keeper<sup>®</sup> loans to be made only on the first business day of the month following the loan closing date. HUD's policy in this regard was espoused in its Mortgagee Letter 00-39 issued November 6, 2000, and Fannie Mae's similar policy was set forth in its Reverse Mortgage Letter 2000-11 dated November 7, 2000. Under this policy, lenders were permitted to disburse funds on a HECM or Home Keeper<sup>®</sup> reverse mortgage loan to a borrower or to others on behalf of the borrower (including such payments advanced by the lender for property taxes, ground rents, hazard insurance, and flood insurance under terms of the loan documents) only on the first business day of a month. This policy apparently was adopted by HUD and Fannie Mae in an effort to fix the initial funding date to correspond to the first business day of succeeding months on which advances "at regular intervals" would be made under contract terms. Seemingly driven by Texas law, this policy required that closings of Texas HECM and Home Keeper<sup>®</sup> loans occur on a day of any month (generally not later than the 25th of

<sup>25</sup> Tex. Const., art. XVI, § 50(k)(6)(A)-(D)

<sup>26</sup> S. J. Res. 7, 79<sup>th</sup> Leg., 2005 Tex. Gen. Laws, amending Tex. Const., art. XVI, §50(p) and (v), effective November 23, 2005

any month) that allows for the running of the full three-business-day federal right of rescission period under the Truth in Lending Act before the scheduled funding date of the loan on the first business day of the next succeeding month. Furthermore, if the borrower's federal right of rescission had not expired by the first business day of the month following the closing date, the initial disbursement on a Texas HECM loan under this policy could not be made until the first business day of the second month following the closing date. Such a policy in practice could cause undue hardship on elder homeowners and administrative burdens on reverse mortgage lenders. Homeowners approved for credit on or after the first day of any month had to wait out the entire remainder of the month before having availability of needed loan funds and, if closing were then delayed beyond the 25<sup>th</sup> of the month for any technical, administrative or other reason, would further be denied funding for yet an additional month. Moreover, because there was no benefit to the homeowner to close earlier in the month, closings for a reverse mortgage lender's entire monthly production tended to be stacked up at month's end in an exerted effort to meet the cutoff date needed to assure timely fundings on the one day permitted.

Furthermore, under Texas practice prior to the 2005 Amendment, repairs required as a condition of the loan to bring the secured property up to standards required under Fannie Mae and HUD Guidelines were required to be fully funded from the initial disbursement of loan proceeds and those funds maintained by the lender in an interest-bearing escrow account to be disbursed as work progressed, subject to the terms of a Repair Rider to the loan agreement. Borrowers consequently were required to pay interest on the entire repair escrow amount from the date of disbursement and establishment of the account rather than interest only on amounts disbursed in progress draws from the dates of disbursement over the 12-month period in which repairs must be completed. Now conforming Texas practice in this regard to the usual "repair set-asides" terms called for by Fannie Mae and HUD Guidelines for other states has the advantages of reducing accrued interest costs to elder homeowners and relieving the administrative burden to loan servicers administering the more formal escrow account arrangement. The enabling language of Section 50(p), as amended, authorizing future advances under a reverse mortgage "at times and in amounts requested by the borrower" effectively authorizes advances requested by the borrower to be made by the lender from repair set-asides to third-party contractors, sub-contractors, and materialmen completing required repairs on the secured homestead property in accordance with terms of the loan agreement and its repair rider.

To implement the line of credit amendments for its Home Equity Conversion Mortgage (HECM) reverse mortgage loan program, which together with the Fannie Mae Homekeeper® loan program accounts for approximately 90% of all reverse mortgages made nationwide today, the Department of Housing and Urban Development (HUD) on March 17, 2006 issued its Mortgagee Letter 2006-06 permitting borrowers under HECM loans closed in Texas on or after March 1, 2006 to choose a *line of credit* payment option (i.e., unscheduled advances at the borrower's request) or any of four other options, including *tenure* (regular monthly payments so long as the borrower occupies the Property), *term* (regular monthly payments for a specific period of time selected by the borrower), *modified tenure* (combination of tenure and line of credit options) or *modified term* (combination of term and line of credit options). HUD also withdrew its earlier guidance found in its Mortgagee Letters 00-09, 00-34, and 00-39 and expressly authorized Texas HECM lenders (i) to establish repair set-asides, or allocations, of funds to be advanced over the first loan year to pay for required repairs to the secured Property (in lieu of a formal escrow of repair funds fully funded at loan closing), and (ii) to make the initial advance under a Texas HECM on any business day after the expiration of the federal three-business-day right of rescission (in lieu of restricting such initial advance solely to the first business day of a month). Fannie Mae had earlier issued its Reverse Mortgage Lender Letter 2006-2 on February 23, 2006, authorizing virtually identical policies for its Texas Homekeeper® reverse mortgage loan program and announcing its intent to purchase FHA-insured HECM reverse mortgage loans on or after March 1, 2006.

#### IV. TITLE INSURANCE COVERAGE FOR THE REVERSE MORTGAGE

##### A. The Need for a Reverse Mortgage Endorsement

Texas mortgage lenders have traditionally shifted 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.

### **B. Adoption of Revised P-45 and T-43 Amendments**

Amendments to the Texas Reverse Mortgage Endorsement (T-43) and Procedural Rule (P-45), *Basic Manual of Rules, Rates and Forms for Writing of Title Insurance in the State of Texas*, were adopted by the Commissioner of Insurance effective June 5, 2000.<sup>27</sup> The amendments are intended to insure against claims of lien invalidity of a covered reverse mortgage arising out of a lender's failure to satisfy certain of the constitutional conditions contained in the 1999 Amendment to the Texas Constitution.

As amended, the Texas Reverse Mortgage Endorsement (T-43) to the Mortgage 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, as amended, 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 mortgagee 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.<sup>28</sup> 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 is-

<sup>27</sup> The proposed amendments were published in 25 Tex. Reg. 2911 and amend the Administrative Code at 28 Tex. Admin. Code § 9.1.

<sup>28</sup> 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.

sued 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.

## **V. Texas Reverse Mortgage Default and Expedited Foreclosure Process**

### **A. Steps to Foreclosure**

**1. *Maturing Events and Default.*** Acceleration of the debt of a Texas reverse mortgage by the lender as the initial step in the foreclosure process, or other enforcement of the lender’s security interest in the homestead property, may only be declared after the occurrence of a constitutional ground for foreclosure, 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 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 (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.

#### **B. The Revised Expedited Foreclosure Procedures — Rule 736.**

Revised 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).

## **VI. CONCLUSION – OUTLOOK FOR THE TEXAS REVERSE MORTGAGE**

Even in this period of a national credit crunch and declining home values, one part of the mortgage market is still hot: reverse mortgages. This boom is in no small part due to the aggressive marketing of almost a dozen competing national mortgage lenders, mostly affiliated with national banks, which have launched new and competing proprietary reverse mortgage programs with a variety of terms previously unavailable through humdrum government insured programs. For example, private proprietary programs are offering fixed-rate terms for the first time and adjustable rate terms with a choice of a LIBOR index and lower margins at adjustment that should result in lower overall costs of borrowing. The programs also are featuring lower front-end fees with resulting higher payouts than government programs. But the adjustable-rate, FHA-insured home equity conversion mortgage (HECM) is still the product of choice for senior homeowners in Texas today for loans that do not exceed the FHA ceiling, which currently ranges from \$200,160 in standard areas to as high as \$362,790 in some high cost metropolitan areas.<sup>29</sup> Despite the competition, HECMs still represent 90% of all reverse mortgage originations nationally. Fannie Mae, the government sponsored secondary market enterprise, both actively purchases FHA-insured HECMs and offers its own conventional reverse mortgage program, the Home Keeper,<sup>SM</sup> with current loan limits for 2007 of \$417,000. National reverse mortgage lenders generally pick up where the HECM and Home Keeper<sup>SM</sup> leave off with proprietary

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<sup>29</sup> This ceiling would be raised under Section 20 of The Expanding American Homeownership Act of 2007 [H. R. 1852 Waters CA-35], which passed the House on September 18, 2007, and is currently pending vote in the U. S. Senate.

“jumbo” products exceeding \$417,000 and a full range of options for senior homeowners. Fannie Mae no longer has a monopoly on reverse mortgage investments. Ginnie Mae, the federal housing finance agency, for example, is rolling out bond issues backed by reverse mortgages for the first time in an effort to boost liquidity in the secondary market for this specialized loan product, and private investment banking houses for several years have been buying up reverse mortgages in the secondary market with plans to package and sell them as collateralized bond investments. As a result of this combination of increased market liquidity, lower fees and higher loan limits, appreciated property values, and today’s lower interest rates seniors today are in a position to put even more of their equity to work for their own health, maintenance, and welfare.

Legislation enacted in the 2003 session of the Texas Legislature<sup>30</sup> 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.<sup>31</sup> 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. The 2005 Amendment also authorized for the first time a line of credit method of advances under a Texas reverse mortgage, which should enable senior Texas homeowners to better regulate the extent and costs of their borrowings and the preservation of their estates. With these new credit terms, reverse mortgage lenders expect reverse mortgages in Texas to triple in volume over the next several years.

The number of Americans age 65 or older has increased tenfold over the past century and comprises today approximately 35 million people, or 13 % of the nation’s total population. Remarkably, with the aging of America’s *baby boomers*, America’s older population is expected to again double by 2030, reaching some 70 million.<sup>32</sup> Texas’ older population, assuming it keeps pace with these projections, would then have burgeoned to over 4.4 million. Moreover, life expectancy for all Americans age 65 in 2000 is another 18 years on average, and the combination of such a large population growth and longer life spans of older Americans undoubtedly will place a strain on their personal financial resources and society’s ability to provide adequate health and elder care services for them. A study funded by the Centers for Medicare and Medicaid Services and the Robert Wood Johnson Foundation<sup>33</sup> concluded that older Americans own almost \$2 trillion in untapped wealth in their homes and that reverse mortgages could be used by millions of older adults to pay the rising costs of long-term care at home. Increasing the market for reverse mortgages, the study further concluded, could save Medicaid alone \$3.3 billion annually in long-term care benefits by 2010. Because home equity is the most significant asset in the estates of most older Americans, the reverse mortgage with its ability to convert that otherwise frozen asset into a stream of annuity-like payments to defray on-going housing, health, and living costs over their remaining lifetimes should prove an increasingly important option for many senior Texas homeowners. ■

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<sup>30</sup> 77(R) H.J.R. 4, Sec. 2

<sup>31</sup> 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.

<sup>32</sup> *Older American 2000: Key Indicators of Well-being*, a study of the Federal Interagency Forum on Aging Related Statistics, accessible at <http://www.agingstats.gov/chartbook2000/population.html>.

<sup>33</sup> “A National Blueprint for Increasing the Use of Reverse Mortgages in Long-Term Care”, The National Council on the Aging, June, 2004