TLC
RESEARCH DIVISION

FACTS AT A GLANCE

Recent Changes in Texas Home Equity Laws Give Homeowners More Choices

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In September 2003, Texas voters approved two amendments to Section 50, Article XVI, of the Texas Constitution that expand the state's home equity lending laws. One amendment (Proposition 16, S.J.R. No. 42) allows lenders to offer Texas homeowners home equity lines of credit. Both Proposition 16 and the second amendment (Proposition 6, H.J.R. No. 23) allow older homeowners to refinance or pay off an existing home equity loan by converting it to a reverse mortgage.

The purpose of this publication is to assist members of the Texas Legislature in providing information on the new home equity lending options to their constituents.

What is home equity?

Home equity is the market value of a house and its adjoining land minus any money borrowed against it.

> ***Example:*** A house purchased three years ago for $100,000 has increased in market value to $130,000. The homeowner has a current mortgage of $90,000 and no other loans secured by the house. Therefore, the homeowner now has **$40,000 of equity** in the house: $130,000 (its current market value) minus $90,000 (the mortgage still owed).

How can Texas homeowners use their home equity?

For many people, a house is their largest asset, and Texas law allows homeowners to use that asset to pay other expenses. Most homeowners are eligible for a ***home equity loan*** or a ***home equity line of credit***, while certain older homeowners may obtain a ***reverse mortgage***. Because a house is such a valuable asset, Texas law also establishes limits on the use of home equity to protect homeowners from the risk of losing their homes. One such limit prohibits homeowners from having more than one home equity loan at a time, although a homeowner may have liens from other sources, such as a home improvement loan or a tax lien. Some of the changes made by the 2003 constitutional amendments allow homeowners who currently have one type of home equity loan to refinance it with another type of home equity loan to comply with the limitation in the law.

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What is the difference between a home equity line of credit and a home equity loan?

Home Equity Line of Credit	Home Equity Loan
The available funds can be used as needed; the borrower does not have to reapply for another loan every time a withdrawal is made.	The funds are disbursed in one lump sum at closing.
The maximum line of credit is 80 percent of the market value of the home minus any loans secured by the home. No additional advances may be made under the line of credit if the total principal amount outstanding exceeds an amount equal to 50 percent of the fair market value of the home as determined on the date the account is established. If the outstanding principal amount exceeds 50 percent of the fair market value of the home as determined at closing, the outstanding principal must be repaid in an amount equal to or below the 50 percent before subsequent advances are permitted.	The maximum loan amount is 80 percent of the market value of the home minus any loans secured by the home.
Each advance must be at least $4,000.	The minimum loan amount is set by the lender, usually $5,000.
The interest rate may be a variable or fixed rate, but it is typically a variable rate.	The interest rate may be a variable or fixed rate, but it is typically a fixed rate for the term of the loan.
Interest is charged only on the balance and begins accruing on the date the money is withdrawn.	Interest is charged on the full loan amount and begins accruing on the date of closing.
Requires that regular payments be made monthly or more frequently by agreement with the lender, but not more often than every 14 days.	Requires that regular payments be made monthly or more frequently, but not more often than every 14 days, and payments must be substantially equal. Typically payments are made monthly.
Interest may be tax deductible.	Interest may be tax deductible.
The money may be used for any type of expense.	The money may be used for any type of expense.

What are the benefits of a home equity line of credit?

- It is a revolving credit account, similar to that of a credit card. The borrower may make withdrawals of at least $4,000 as needed, up to the credit limit. The credit limit remains in place as the loan is paid down, so the borrower can continue withdrawing from the account as long as that limit is not exceeded.
- The interest on a home equity line of credit is generally lower than other types of credit, including credit cards and signature loans. Lenders may tie the interest rate to the prime interest rate, which is determined by the Federal Reserve. Last revised in June 2003 and in effect as of the date of this publication, the current prime rate is 4% (see http://www.usprimerates.com). Many Texas lenders are offering interest rates that are at or slightly below the prime interest rate for home equity line of credit accounts.
- It generally has low closing costs. Some Texas lenders are waiving closing costs to attract borrowers for these new accounts.
- It is a convenient way of paying for ongoing and unplanned expenses, such as home improvement projects, education and medical expenses, and such major life events as a wedding or a new baby. It can also be used to pay off loans that have higher interest rates, including credit card accounts.
- Many lenders will allow a home equity loan to be refinanced with a home equity line of credit if the borrower has had the loan for 12 months or longer and has not refinanced it within the past year.
- The interest paid on a home equity line of credit may be tax deductible if the money is used for certain expenses. A tax specialist can determine if a particular expense meets Internal Revenue Service (IRS) criteria.

What are the risks of a home equity line of credit?

- As with a home equity loan, if the borrower fails to make a payment, the lender can foreclose, and the borrower can lose his or her home.
- The readily available money may result in some homeowners making frivolous or unwise purchases.
- Typically the interest rate is set at a variable rate that is tied to the prime interest rate, which, if it rises significantly, can result in the borrower paying a much higher rate than anticipated.

What is a reverse mortgage?

A reverse mortgage is a loan that allows older homeowners to convert a portion of their home equity into cash without selling the home. The borrower or the borrower's spouse must be at least 62 years of age. The borrower must live in the home at least six months of each year and must either own the home outright or have a low mortgage balance that can be paid off at the closing with the proceeds from the reverse mortgage. The loan amount depends on the borrower's age, the equity in the home, and the market value of the home. A reverse mortgage does not need to be repaid unless the borrower no longer uses the home as a principal residence—that is, if the borrower sells the home, does not live in the home for an extended period of time, or dies.

Reverse mortgages have been available to Texas homeowners for several years and have become a popular way for seniors to tap into their home equity. Like home equity lines of credit and home equity loans, reverse mortgages have numerous benefits as well as risks. Before closing on a reverse mortgage, a homeowner is required to attend financial counseling to make sure the terms of the loan are fully understood.

Why did Texas legislators recently amend the home equity laws to allow a home equity loan to be paid off with a reverse mortgage?

Prior to the availability of reverse mortgages in Texas, many homeowners who would have preferred reverse mortgages obtained home equity loans instead. The 2003 amendments allow those borrowers to convert their existing home equity loans into reverse mortgages.

Can Texas homeowners receive a reverse mortgage as a home equity line of credit?

No. Under current law, the proceeds from a reverse mortgage can be received either as a lump sum or in fixed monthly payments.

What other changes were recently made in Texas home equity laws?

Proposition 6 included a provision that gives a lender 60 days to correct any overcharges or certain other errors the lender may have made when it issued a home equity line of credit. The new law also requires a lender to forfeit all the principal and interest of a home equity line of credit if it allowed an unauthorized person to issue the loan or if the loan agreement was created without the consent of each borrower and each borrower's spouse.

Additional Resources

Texas homeowners can contact a bank, credit union, or other lending institution for information about obtaining a home equity line of credit, a home equity loan, or a reverse mortgage. General questions about Texas home equity lending laws can be directed to the Office of Consumer Credit Commissioner (OCCC), which regulates the credit industry in Texas. The OCCC is located at 2601 N. Lamar Boulevard, Austin, Texas 78705. Inquiries may be made to its toll-free Consumer Helpline, 800-538-1579, or by e-mail to info@occc.state.tx.us. The OCCC's Internet website—http://www.occc.state.tx.us—provides proposed and adopted rules as well as consumer brochures, in English and in Spanish, relating to home equity lending in Texas. Additional information about home equity lending is also available from:

AARP
601 E Street, NW
Washington, DC 20049
800-424-3410
www.aarp.org

Federal Reserve Board
20th Street and Constitution Avenue, NW
Washington, DC 20551
202-452-3000
www.federalreserve.gov

Federal Trade Commission
Customer Response Center
600 Pennsylvania Avenue, NW
Washington, DC 20580
877-382-4357
www.ftc.gov

National Center for Home Equity Conversion
360 N. Robert Street, #403
St. Paul, MN 55101
651-222-6775
www.reverse.org

U.S. Department of Housing and
Urban Development (HUD)
451 7th Street SW
Washington, DC 20410
202-708-1112
www.hud.gov

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