Credit Union Department

Informational Memorandum

TO: Credit Union Presidents and CEOs

FROM: Harold E. Feeney, Commissioner

DATE: October 24, 2017

SUBJECT: GUIDANCE FOR CREDIT UNIONS AND BORROWERS AFFECTED BY HURRICANE HARVEY – HOME EQUITY LOANS AND HOME REPAIRS

The Credit Union Department recognizes the impact that natural disasters such as Hurricane Harvey have on both members and credit unions. The Department fully anticipates that credit unions will be making new loans to assist in recovery efforts and may need to adjust terms or temporarily extend maturities of existing loans where circumstances warrant, and regulatory compliance and safety and soundness is not compromised. Credit unions should identify distressed borrowers and monitor their progress to resolve financial difficulties caused by Hurricane Harvey. The Department is supportive of measures that will help borrowers recover and provide an opportunity to ultimately repay their debt. The purpose of this notice is to provide additional guidance to credit unions about the options and potential problem areas of extending new loans and renewing or modifying existing consumer loans.

Loans for Home Repair

Many homes in declared disaster areas need repairs and rehabilitation, and homeowners may seek to borrow funds for that purpose. A member may seek a home equity loan, a home equity line of credit (HELOC), or a home improvement loan. Members with an existing home equity loan may seek assistance if the loan is in danger of default in the form of a modification or a refinance, with or without additional cash advanced. These situations have **constitutional implications**, and credit unions should proceed with caution before modifying a home equity loan.

Loan Options – New versus Existing Loan

New Loans - For a new home equity loan or HELOC, the funds advanced, when added to the outstanding principal balance of all other loans secured by the homestead, may not exceed 80% of the homestead's fair market value (FMV) at the time the loan is made, as determined by a current appraisal. However, the FMV of a flooded property will likely have declined due to the resulting damage, which may make this option unavailable.

Alternatively, a homeowner could apply for a home improvement loan to make repairs to the homestead. A home improvement loan is not subject to a loan-to-value (LTV) requirement but is typically evaluated based on the expected value after improvements are completed. Further, the closing for a home improvement loan is subject to a shorter waiting period (5 days) than a home equity loan or

HELOC. However, obtaining an adequate appraisal may be difficult during recovery efforts when resources are stretched thin.

Existing HELOC – A homeowner with an existing HELOC may be able to obtain an additional advance on the HELOC. Because the maximum amount of a HELOC is determined at the time the HELOC was closed, additional draws are possible if the current outstanding balance on the HELOC is less than 50% of the FMV at closing. The minimum draw on an existing HELOC may not be less than $4,000.

Refinance of Existing Home Equity Loan – Although no additional funds are available to be drawn under an existing home equity loan, additional funds might be available through a refinance, provided the current FMV of the homestead will support the amount financed. An existing home equity loan may be refinanced without regard to the one-year seasoning requirement if the homestead is located within an area that has been declared a "disaster" by the Governor or the President of the United States, and if the homeowner requests the closing less than one year from the original closing due to the emergency or disaster.

Modification of Existing Home Equity Loan – An existing home equity loan may be modified at the request of the homeowner without violating the Texas Constitution if the modification is consistent with the opinion of the Texas Supreme Court in *Sims v. Carrington Mortg. Services, L.L.C.*, 440 S.W.3d 10 (2014). In the context of an existing home equity loan in default, the court held that a new agreement with the borrower that capitalizes past-due interest, fees (late charges), property taxes, and insurance premiums into the principal of the loan (all past-due amounts owed under the terms of the initial loan) and a lowering of the interest rate and the amount of installment payments, but does not involve the satisfaction or replacement of the original note, an advancement of new funds, or an increase in the obligations created by the original note, is not a new extension of credit for purposes of section 50 of Article XVI of the Texas Constitution. Further, the Court held that the capitalization of past-due interest, taxes, insurance premiums, and fees was not an "advance of additional funds" within the meaning of Section 50(a)(6) if those amounts were among the obligations assumed by the borrower under the terms of the original loan.

As noted in 7 Texas Admin. Code § 153.14(2), a home equity loan and a subsequent modification are considered a single transaction for purposes of the home equity lending requirements of Section 50(a)(6)., including the percentage cap on loan fees.

Although the *Sims* case did not explicitly involve traditional payment deferrals or an extension of the term of the original note, we believe these to be permissible under the Court's holding that "[t]he Constitution does not prohibit the restructuring of a home equity loan that already meets its requirements in order to avoid foreclosure while maintaining the terms of the original extension of credit." **A credit union must satisfy conditions set forth in the Texas Constitution in order to have a valid home equity lien. We recommend that management consult with legal counsel before engaging in these types of loan modifications for home equity loans.**

This Informational Memorandum is not an interpretation of the Texas Constitution and is not being issued under Texas Finance Code §§11.308 and 15.413.

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