Lender FAQs: Understanding Texas Home Equity Loan Modifications

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As interest rates decline in 2024, lenders who make home loans to Texas residents are seeing an uptick in loan modification requests. Although a “mod” for a conventional loan is straightforward, there are – as always – unique challenges when it comes to home equity loans. This article will explore some key issues Texas lenders may want to consider when navigating these modifications.

Does the home equity lending statute apply to a “mod”?

Yes, the home equity lending statute and the Interpretations (regulations)[1] will still apply. The regulations state that “the home equity requirements of Section 50(a)(6) will be applied to the original loan and the subsequent modification as a single transaction.”[2] This can be both good and bad. The constraints on home equity loans apply, but most lenders should be able to accommodate the requested modifications within their existing loan platform. In turn, this could make it quick and inexpensive for lenders to make loan mods that only change the applicable interest rate.

What changes are permitted?

The lender and the borrower can agree to add, delete, or modify any loan provision as long the changes are compliant with the Texas home equity statute and regulations. The regulations state that “a modification of an equity loan may not provide for new terms that would not have been permitted by applicable law at the date of closing of the extension of credit.”[3] For example, there is no constraint (other than the usury limit) on the interest rate, which can be “any fixed or variable rate of interest authorized under statute”.[4] On the other hand, the loan cannot be restructured to have a balloon payment, which is prohibited by the Constitutional provision that requires the loan to be scheduled to be repaid in “substantially equal successive periodic installments”.[5] This requirement is more complicated for a home equity line of credit, which must take into consideration the draw period as well as the repayment period.

Can the borrower request a “mod” by phone or online?

Yes, the borrower can make the request by phone, online, or in person, but the actual modification agreement must be in writing and signed by the lender and borrower.[6] Some exceptions apply for deployed military personnel and other individuals.

Can the borrower get a "mod" within a year after their last home equity loan?

As lenders know, a borrower cannot close a new home equity loan within one year after obtaining a prior home equity loan, except for a declared state of emergency.[7] This rule does not apply to loan mods. A home equity loan mod can be made within the 12-month period.[8]

Is a cooling off period required?

Unlike the original home equity loan, there is not a cooling-off period before a loan mod can close. Also, the borrower does not have a right to rescind the modification agreement. Because the note is not replaced, and the deed of trust is (usually) unaffected, the lien on the property is continuingly valid and the funds can be disbursed to the borrower immediately.

Can the borrower get additional funds?

One of the most complicated aspects of a home equity loan modification is determining what amounts are permitted and the new principal balance. The borrower cannot "walk away from the table" with any additional funds,[9] but the lender must also consider whether and how to capitalize unpaid principal and interest, taxes, and insurance premiums, and whether to take into account PMI coverage and other items. Modifications to the deed of trust present special considerations that go beyond home equity lending issues and require the assistance of a skilled real estate attorney in many cases.

Can the borrower get out of the home equity loan entirely?

As lenders know, a home equity loan can be converted into a conventional loan by following the specific requirements in the Texas Constitution.[10] However, such a transaction would not qualify as a modification. It is considered a refinance.[11]

Can we charge a fee for the "mod"?

Yes, but bear in mind that because the regulator will treat the original loan and the mod as one transaction, the 2% cap on fees will apply. Also, if the lender has title insurance, the title company, in most cases, will charge a fee for modifying or updating the policy. On the other hand, other costs that are excluded from the 2% cap, such as a title search or survey, should not be necessary. The lender may want to obtain a new appraisal in some circumstances. Generally, a loan mod can be cost-effective for the lender and the borrower. The process should also be brief and only as complicated as it needs to be.

For Texas lenders navigating the complexities of home equity loan modifications, McGlinchey's experienced team is well-versed in the specific challenges these modifications present and can provide tailored guidance to ensure compliance with Texas law. If you have questions, please contact the author or McGlinchey's Mortgage Lending Compliance team.

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[1] Tex. Const., art. 16, §50(a)(6); Tex. Admin. Code, title 7, ch. 153.

[2] Tex. Admin. Code, title 7, Rule §153.14(2).

[3] Tex. Admin. Code, title 7, Rule §153.14(2)(C).

[4] Tex. Const., art. 16, §50(a)(6)(O).

[5] *Id*. at §50(a)(6)(L)(i).

[6] Tex. Admin. Code, title 7, Rule §153.14(2)(A).

[7] TEX. CONST., art. 16, §50(a)(6)(M)(iii).

[8] Tex. Admin. Code, title 7, Rule §153.14(2).

[9] Id. at Rule §153.14(B).

[10] *See* TEX. CONST., art. 16, §50(f) and (f-1).

[11] *Id.*

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