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Where Lenders Fear to Tread



small banks shun home equity lending

by Jack C.
Harris

As anyone who pays attention to advertising can attest, several lenders have mounted aggressive campaigns to attract homeowners. A surprisingly large number of lenders, however, have decided to shun the publicity blitz. Many have decided to stay out of the business altogether.

Late last summer, the Real Estate Center, in cooperation with the Texas Bankers Association, polled lenders on the home equity question. Of the 351 respondents, fewer than 19 percent said they were actively promoting home equity loans.

Almost half of the sample were making loans without any special promotion.

Last January was to have been the beginning of a major effort by lenders to capture the state's home equity business, a market off limits until voters amended the constitution the previous fall.

And almost a fourth had no plans to enter the market. Furthermore, for those making loans, more than 60 percent said they had originated less than \$500,000 in loan volume in the approximately six months since the loans were authorized.

Most of the hold-outs were small community banks. All respondents with at least \$500 million in deposits were making home equity loans, with two-thirds of those actively promoting the product.

Why the hesitation after so many years of petitioning the legislature for a chance to make home equity loans? Clearly, the problem is the extensive list of requirements for a valid home equity lien placed

in the constitutional amendment.

Not only do these stipulations add to the complexity of originating home equity loans, many are written in confusing, and sometimes self-contradictory, language. The result is that a lender making a home equity loan may not be able to enforce the lien because of an inadvertent violation of legal procedures. When the respondents were asked what they felt was the biggest risk connected with home equity loans, three-fourths mentioned the possibility of an unenforceable lien because of unclear legal provisions.

Specific problems with the amendment are examined in Judon Fambrough's "Potential Pitfalls Face Texas Home Equity Lenders," in the September 1998 issue of the Center's periodical *Letter of the Law*. The survey of bankers asked respondents to rate how big a problem they had with a list of requirements given them.

Lenders see two of these as major problems. A majority of respondents consider the mandatory use of judicial foreclosure and the lack of borrower personal liability to be major problems. Lenders trying to cure a default must go through the lengthy and costly procedure of court-supervised foreclosure and, should that not satisfy the debt, they

cannot seek a deficiency judgment from the borrower.

The 3 percent cap on fees was mentioned frequently. Of additional concern was the one-acre limit on urban homesteads and the prohibition against loans on homesteads that receive agricultural-use exemptions.

The 1997 constitutional amendment was the result of extensive compromise between lenders and consumer advocacy groups. In an effort to placate opposition to the bill, the legislation was filled with a long list of requirements designed to protect borrowers who might otherwise be vulnerable to aggressive sales tactics.

Each provision creates a potential liability for the lender. Ironically, many of the "protections" are seen as nuisances by borrowers as well. For example, borrowers have complained about the 12-day wait between application and loan closing.

More important is the problem of legislative language that makes com-

pliance uncertain, even for the most circumspect lender. Because it is part of the constitution, changes aimed at making the law less intrusive, or even less vague, will be difficult and time consuming.

Eventually, these issues will be sorted out as the courts are called upon

to interpret provisions of the law. For the time being, many of the state's smaller lending institutions are choosing to avoid being potential litigants in those cases. □

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