May 16, 2014

To Clients and Friends:

Today the Texas Supreme Court rendered its Opinion in *Sims v. Carrington Mortgage Services*. In this case, the United States Court of Appeals for the Fifth Circuit certified the four questions to the Texas Supreme Court regarding whether a particular transaction of a Texas home equity loan is a modification or a refinance for home equity purposes. The purpose of this Memo is to address what we consider the substance of the Opinion.

Facts of the case:

In the case, Frankie and Patsy Sims obtained a 30-year home equity loan in 2003. In 2009, the Simses, behind on their payments, reached what was entitled a "Loan Modification Agreement" with Carrington Mortgage Services, L.L.C. The agreements involved capitalizing past-due interest and other charges, including fees and unpaid taxes and insurance premiums, and reducing the interest rate and monthly payments. Two years later, the Simses were again behind, and this time CMS sought foreclosure. The Simses resisted, asserting that the 2009 restructuring violated constitutional requirements for home equity loans.

Questions and Answers:

Fifth Circuit certified the four questions and the Supreme Court gave the following answers:

1. After an initial extension of credit, if a home equity lender enters into a new agreement with the borrower that capitalizes past-due interest, fees, property taxes, or insurance premiums into the principal of the loan but neither satisfies nor replaces the original note, is the transaction a modification or a refinance for purposes of Section 50 of Article XVI of the Texas Constitution?

Court's Answer:

"the restructuring of a home equity loan that, as in the context from which the question arises, involves capitalization of 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 that must meet the requirements of Section 50**."

2. Does the capitalization of past-due interest, fees, property taxes, or insurance premiums constitute an impermissible "advance of additional funds" under Section 153.14(2)(B) of the Texas Administrative Code?

Court's Answer:

"No, if those amounts were among the obligations assumed by the borrower under the terms of the original loan. And more importantly, **such capitalization is not a new extension of credit under Section 50(a)(6)."**

3. Must such a modification comply with the requirements of Section 50(a)(6), including subsection (B), which mandates that a home equity loan have a maximum loan-to-value ratio of 80%?

Court's Answer:

"No, because **it does not involve a new extension of credit**, for the reasons we have explained."

4. Do repeated modifications like those in this case convert a home equity loan into an open-end account that must comply with Section 50(t)?

Court's Answer:

"Section 50(t) applies to a home equity line of credit — "a form of an openend account that may be debited from time to time, under which credit may be extended from time to time and under which . . . the owner requests advances, repays money, and reborrows money". The repeat transactions are clearly contemplated from the outset. **This description does not remotely resemble a loan with a stated principal that is to be repaid as scheduled from the outset but must be restructured to avoid foreclosure."**

If you have questions concerning this information, please feel free to contact any of our attorneys.