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ATTORNEYS AT LAW

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To Clients and Friends:

We wanted to take a minute to advise you of a recent decision of the Dallas Court of Appeals relating to a Texas home equity loan. In *Wells Fargo Bank, N.A., as Trustee for Option One Mortgage Loan Trust 2006-1 Asset-Backed Certificates, Series 2006-1 v. Lonzie Leath*, the borrower, Mr. Leath, had sought to invalidate a home equity loan on the grounds that the loan exceeded 80% of the fair market value of the property, which as you probably know is the limit imposed by Article XVI, Section 50(a)(6)(B) of the Texas Constitution.

In this case, the appraisal conducted at the time of the closing of the loan indicated that the home had a fair market value of \$425,000. The loan amount was \$340,000 and so from the documents available at the time of closing, it appeared that the loan complied with the 80% FMV limitation imposed by Section 50(a)(6)(B) and the Borrower executed an affidavit at the closing confirming the value used in this calculation. However, after the loan closed, the borrower had difficulty repaying the adjustable rate loan because the interest rate reset and sent the lender a letter asking to modify or restructure the loan to avoid foreclosure. When the request was denied, the lender commenced foreclosure proceedings and, in defense the Borrower filed an action to abate the foreclosure action, alleging that the outstanding debt at the time of the closing exceeded 80% of the fair market value of the property notwithstanding the appraisal and Affidavit of Fair Market Value executed at closing.

At the trial, the appraiser for the lender confirmed his \$425,000 value for the property, but conceded that there was approximately \$3600 of electrical repairs that were necessary and this amount should have been deducted from the \$425,000 value, which would result in an "as is" fair market value for the property of \$421,400. The jury found that this was the fair market value of the property as of the date of the closing and the trial court therefore concluded that the maximum loan amount for the transaction should have been \$337,120. In addition, the trial court found that the Borrower had provided adequate notice of the defect in the home equity loan when the Borrower filed its action to abate the foreclosure action. The trial court further found that the lender had failed to cure the defect within the 60-day window allowed under the Texas Constitution and the Texas Administrative Code. As a result, the trial court found that the lender's lien on the property was VOID, the principal and interest on the note should be forfeited, and the Borrower should be awarded attorney's fees. The Dallas Court of Appeals AFFIRMED this judgment, finding that there was adequate evidence to support the jury's finding on the fair market value of the property and the trial court had otherwise acted properly in addressing the Borrower's remedies under applicable law.

In the appeal, in addition to challenging the finding on the fair market value of the property, the lender also argued it was entitled to equitable subrogation for the \$279,581.74 of its loan proceeds that were used to pay off the prior valid lien on the property. The Court of Appeals denied this defense on the basis that the lender had failed to properly raise this defense at trial.

Noticeably absent from the Court of Appeals decision is any discussion of Article XVI, Section 50(h) of the Texas Constitution, which provides:

(h) a lender or assignee for value may conclusively rely on the written acknowledgment as to the fair market value of the homestead property made in accordance with Subsection (a)(6)(Q)(ix) of this section if:

- (1) the value acknowledged to is the value estimate in an appraisal or evaluation prepared in accordance with a state or federal requirement applicable to an extension of credit under Subsection (a)(6); and
- (2) the lender or assignee does not have actual knowledge at the time of the payment of value or advance of funds by the lender or assignee that the fair market value stated in the written acknowledgment was incorrect.

It is quite possible that this issue was not raised on a timely basis in the trial court or in the briefing before the Dallas Court of Appeals. However, the lack of discussion in the decision of this important legal point is certainly troubling for lenders in the Texas home equity arena.

This decision is a reminder to lenders that, when presented with notice of a defect in a home equity loan, it is critical to act within the statutory time frame to effect a cure. Also, if a dispute on a home equity loan becomes a litigation matter, it is critical to plead all available defenses (such as subrogation and conclusive reliance provisions of Section 50(h) of Article XVI of the Texas Constitution). Please note that it is still possible that the lender in this case may successfully appeal this decision to the Texas Supreme Court.