

Title 7. Banking and Securities
Part 5. Office of Consumer Credit Commissioner
Chapter 89. Property Tax Lenders
§§89.207, 89.601, & 89.802

The Finance Commission of Texas (commission) adopts amendments to §§89.207, 89.601 and 89.802, concerning Property Tax Lenders.

The commission adopts the amendments to §§89.207, 89.601 and 89.802 without changes to the proposed text as published in the May 1, 2015, issue of the *Texas Register* (40 TexReg 2353).

In general, the purpose of the adopted amendments is to provide guidelines for charging legitimate discount points in connection with property tax loans. The amendments replace a portion of a previously adopted rule that prohibited discount points in §89.601(d), which appeared in the March 6, 2015, issue of the *Texas Register* (40 TexReg 1068).

At the commission's meeting on April 17, 2015, individuals from the following organizations provided oral testimony supporting the proposal: Protect My Texas Property and the Texas Property Tax Lienholders Association. In addition, the commission received three written comments on the proposal from the following organizations and entities: the Law Firm of Daniel J. Young, PLLC; Sombrero Capital, LLC; and the Texas Property Tax Lienholders Association. One commenter supported the proposed recordkeeping and disclosure requirements, but opposed the prohibition on including discount points in the principal balance or funds advanced. The other two commenters were generally supportive of the amendments, although one of these

supportive commenters suggested additional requirements for legitimate discount points, including bona fide discounts and additional disclosures. A more detailed analysis of the comments is included after the purpose discussion regarding §89.601(d).

The agency originally received informal pre-comments on property tax loan discount points at a stakeholder meeting held in September 2014. Stakeholders also provided official comments regarding property tax loan discount points in response to proposed rule amendments that appeared in the October 31, 2014, issue of the *Texas Register* (39 TexReg 8484) and the December 26, 2014, issue of the *Texas Register* (39 TexReg 10122). The commission has considered these official comments and informal pre-comments in developing the current amendments.

I. Summary of adopted amendments

The amendments to §89.207, concerning Files and Records Required, add clause (x) to paragraph (3)(A) concerning the property tax loan transaction file. The amendments specify that a property tax lender must maintain written documentation of discount points offered to the property owner, including a written proposal that includes a contract rate without discount points and a lower contract rate based on discount points.

The amendments to §89.601, concerning Fees for Closings Costs, are contained in subsection (d). The amendments to §89.601(d) address the

charging of legitimate discount points in connection with a property tax loan. Subsection (d) states that legitimate discount points are not subject to the general maximum fee limit for property tax loan closing costs described by §89.601(c). Paragraph (1) explains that in order for discount points to be legitimate, they must truly correspond to a reduced interest rate, they cannot be necessary to originate the loan, and the borrower must be provided with a written proposal that includes a contract rate without discount points and a lower contract rate based on discount points.

New §89.601(d)(2) states that any discount point or other origination fee that does not meet the definition in paragraph (1) will be subject to the general maximum fee limit described by subsection (c). New §89.601(d)(3) specifies that legitimate discount points must be included in the calculation of the effective rate and upon prepayment in full, must be spread under Texas Finance Code, §302.101. New §89.601(d)(4) specifies that discount points must be paid by the borrower at or before closing of the loan, and that discount points may not be included in the funds advanced or principal balance. New §89.601(d)(5) specifies that a lender may not finance discount points through a promissory note or contract payable to the property tax lender or an affiliated business.

The amendments to §89.802, concerning Payoff Statements, add subparagraph (C) to paragraph (9) concerning the itemization of the total payoff amount. The amendments to §89.802 provide that any refunds resulting from unearned legitimate discount points must be itemized on the payoff statement.

II. Purpose and justification

The amendments have three primary purposes. First, they help ensure that any discount points charged by a property tax lender are legitimate prepaid interest, rather than a disguised closing cost in violation of Texas Tax Code, §32.06(e). Texas courts have generally held discount points to be a form of prepaid interest. *See, e.g., Fin. Comm'n of Tex. v. Norwood*, 418 S.W.3d 566, 596 (Tex. 2013) (holding that legitimate discount points are interest and are not subject to the Texas Constitution's 3% cap on fees necessary to originate a home equity loan); *Tarver v. Sebring Capital Credit Corp.*, 69 S.W.3d 708, 713 (Tex. App.--Waco 2002, no pet.) (holding the same). Like other forms of prepaid interest, discount points must be spread over the term of the loan in order to determine whether the loan is usurious. *See* Tex. Fin. Code §302.101; *Tanner Dev. Co. v. Ferguson*, 561 S.W.2d 777, 786-87 (Tex. 1977). However, in order to be legitimate, discount points must be an option available to the borrower, rather than a fee necessary to originate the loan. *See Norwood*, 418 S.W.3d at 596 (explaining that "true discount points are not fees 'necessary to originate, evaluate, maintain, record, insure, or service' but are an option available to the borrower").

In addition, paragraphs (4) and (5) help ensure that property tax lenders comply with the limitation on funds advanced in Texas Tax Code, §32.06(e), which provides: "A transferee holding a tax lien transferred as provided by this section may not charge a greater rate of interest than 18 percent a year on the funds advanced. Funds advanced are limited to the taxes, penalties, interest, and collection costs paid as shown on the tax receipt, expenses paid to record the lien,

plus reasonable closing costs." This provision distinguishes between interest that the property tax lender may charge and funds that the property tax lender may advance to the borrower. Funds advanced are expressly limited to the six items listed in the second sentence of §32.06(e). The interest that the property tax lender can charge is described in the first sentence of §32.06(e), and is not part of the funds advanced. There is no indication in §32.06(e) that a property tax lender may charge interest on its own interest. *See William C. Dear & Assocs., Inc. v. Plastronics, Inc.*, 913 S.W.2d 251, 254 (Tex. App.--Amarillo 1996, writ denied) (interpreting a usury statute to prohibit compounding of interest where it was not expressly authorized). For this reason, discount points (as a form of prepaid interest) are not part of the funds advanced under Texas Tax Code, §32.06(e), and should not be included in the principal balance of the loan, as specified in paragraph (4). In addition, paragraph (5) specifies that a lender may not circumvent this requirement by entering into a promissory note or contract for the payment of discount points.

Third, the amendments ensure transparency in connection with discount points. By requiring a complete written disclosure of the contract rate and annual percentage rate with and without discount points, the amendments enable borrowers to make an informed decision before closing.

The amendments address three problems with discount points that were described in written comments on the December 26 re-proposal of the previous version of this rule.

First, the comments on the December 26 re-proposal revealed that certain property tax lenders have used discount points as disguised closing costs, rather than an option to obtain a lower interest rate. For example, one commenter expressed concern "that a handful of licensees are attempting to disguise a portion of their closing costs as discount points. . . . [C]ertain licensees originate transfers but immediately sell them to an unrelated funding company, keeping the closing costs and 'discount points' as their sole compensation for each transaction. What this practice has created is a system whereby these originators have incentive to charge high discount points, although the rate charged by the licensee actually funding the loan does not decrease proportionally." Along the same lines, some comments suggested that certain property tax lenders currently rely on discount points as a primary source of funding. For example, one commenter stated: "Without our own funding capabilities, we rely on the origination fees and discount points to be able to meet our financial obligations in running our business." In other words, certain property tax lenders are relying on discount points in order to compensate them for the costs incurred in closing a loan. Discount points should be a method for providing borrowers with an option to obtain a lower interest rate. They should not be a method of maximizing profits or charging disguised closing costs. In order to be legitimate, discount points must be an option available to the borrower, rather than a fee necessary to originate the loan. *See, e.g., Fin. Comm'n of Tex. v. Norwood*, 418 S.W.3d 566, 596 (Tex. 2013). The comments did not indicate that any property tax lenders have offered a borrower a clear statement of the option to obtain a higher interest rate, versus a lower rate with discount points.

Second, the comments on the December 26 re-proposal revealed that certain property tax lenders have included discount points in the principal balance of property tax loans, in violation of the limitation on funds advanced in Texas Tax Code, §32.06(e). For example, one commenter was affiliated with a property tax lender that has charged discount points, and objected to the prohibition on including discount points in the principal balance of a loan. This commenter stated: "Overwhelmingly, the property owner who is seeking a tax lien loan is cash strapped. . . . Requiring discount points to be paid in cash takes yet one more option away from borrowers who have precious few options in the first place." Ten other commenters on the December re-proposal supported the prohibition on including discount points in the principal balance of a property tax loan. For example, one commenter supported "ensuring that prepaid interest is kept separate from interest bearing principal to avoid charging property owners interest on the prepaid interest."

Third, the comments on the December 26 re-proposal revealed that discount points for property tax loans can be confusing and not sufficiently transparent to borrowers. One commenter stated: "Approximately half of our customers do not have a mortgage and therefore have probably not been exposed to the concept of discount points." In the case of financed discount points, the property tax lender exaggerates the apparent savings that the borrower is receiving in exchange for paying for the discount points. It may appear to the borrower that there will be a substantial savings through an interest rate reduction, but this savings is partially offset by the extra principal that the borrower will have to repay over the life of the loan. In addition, as discussed previously, the comments did not indicate

that any property tax lenders have offered a borrower a clear statement of the option to obtain a higher interest rate, versus a lower rate with discount points.

III. Comments on proposed amendments

The commission received three written comments on the May 1 proposal containing the current amendments.

One commenter supported the rule, stating that although it would "prefer the prohibition of discount points altogether, we are in support of the proposed amendments, and believe the rules will ensure property tax loans are provided fairly and sensibly to property owners." The current amendments replace a portion of a previously adopted rule that prohibited discount points in §89.601(d). The commission believes that the current amendments provide sufficiently clear guidelines to address the discount-point-related problems discussed earlier.

One commenter supported the rule, stating: "I applaud your office's continuing efforts to protect consumers of property tax loans. The proposed amendments are reasonable and will not negatively impact my business." However, this commenter suggested additional requirements. First, the commenter suggested: "Discount point charges must be paid up-front." The commission has addressed this suggestion through new §89.601(d)(4), which requires discount points to be paid by the borrower at or before closing of the loan, and provides that discount points may not be included in the funds advanced or principal balance. Second, the commenter suggested that the "OCCC must demand customers receive fair and bona [fide] rate reductions from market rates," and that a "single discount point must have a minimum value of 25 basis points."

The commission believes that the requirements for legitimate discount points in subsection (d) are sufficient to provide guidance on which discount points will be considered legitimate. The agency will monitor the industry's use of discount points to determine whether more detailed calculation requirements should be proposed in the future. The commission declines to add further discount point calculation requirements for this adoption. Third, the commenter suggested that the rule should require the originator to remit any discount points to a subsequent lienholder, stating: "Proceeds from discount points must be held by the ultimate lienholder, because a refund will have to be issued if the loan is satisfied early." The commission believes that this requirement would be outside the scope of §32.06(e), which does not address circumstances under which prepaid interest must be retained by an originating lender. Accordingly, the commission declines to incorporate this suggestion into the adoption. Fourth, the commenter suggested that all discount points should be subject to the \$900 fee cap described in §89.601(c)(3), stating: "It defeats the purpose of the fee cap if it can be easily exceeded through discount points." For the reasons discussed earlier, legitimate discount points are prepaid interest, and are therefore subject to the 18% interest limitation described in Texas Tax Code, §32.06(e), rather than the limitation on closing costs. However, the commission agrees that discount points should not serve as disguised closing costs. The new language in §89.601(d)(2) partially addresses the commenter's concern by specifying that lenders may not use the term "discount point" to describe any charge other than a legitimate discount point, and that any non-legitimate discount points are subject to the closing cost limitation. Fifth, the commenter suggested that lenders be

required to provide the following disclosure: "Discount points are optional charges for your property tax loan. Other property tax lenders may offer similar rates without charging you fees for discount points. You should inquire [about] discount point policies from other licensed property tax lenders. Contact the Office of Consumer Credit Commissioner's Office should you have any questions, 800-538-1579." The commission believes that subsection (d)(1)(C) provides property owners with appropriate guidance about their options for discount points. The agency will continue to monitor this issue. The commission believes that a disclosure of the OCCC's contact information is unnecessary in the written proposal for discount points, because the borrower already receives this information under §89.504(a)(14) as part of the disclosure statement that must be provided to the borrower before closing.

One commenter supported the proposed recordkeeping and disclosure requirements, but opposed the prohibition on including discount points in the principal balance or funds advanced. The commenter argued that many borrowers are unable to pay for discount points up front, stating that "a property owner's ability to have quick access to cash, check or electronic funds transfer usually isn't part of why the need the transferees help. Many homeowners are already involved in a lawsuit with the taxing authorities--often facing imminent foreclosure. Some have found themselves in a bind after losing a job or with unexpected, urgent expenses. . . . [N]o matter how much a property owner wanted to utilize discount points--as expressly authorized by these rules--she would be prevented from doing so unless she had access to cash on hand." As discussed previously, discount points must be excluded from the principal balance and

funds advanced, in order to ensure that the property tax lender does not violate the limitation on funds advanced in Texas Tax Code, §32.06(e). For this reason, the commission disagrees with the commenter's suggestion to remove the prohibition on financing discount points. In response to the commission's statement that lenders could recoup costs of compliance by charging a higher rate of interest, the commenter also stated that the amendments would "provide a justification for the increase in industry interest rates." The commission disagrees with this comment. Property tax lenders are still free to offer lower interest rates than their competition. A property tax lender that currently offers financed discount points at lower-than-market rates could provide substantially the same benefit by offering an interest rate without discount points that is lower than competitors' rates. This approach would have the added benefits of ensuring that the discount points are not disguised closing costs, ensuring that the lender does not violate the limitation on funds advanced, and providing clearer, more transparent information to the borrower.

IV. Conclusion

The amended provisions in this adoption will apply only to loans made on or after the effective date of these rules, which is anticipated to be July 9, 2015.

The amendments are adopted under Texas Finance Code, §351.007, which authorizes the commission to adopt rules to ensure compliance with Texas Finance Code, Chapter 351 and Texas Tax Code, §32.06. The amendments help ensure that lenders comply with the limitations on interest, closing costs, and funds advanced in Texas Tax Code, §32.06(e). They also help ensure that lenders comply with Texas

Finance Code, §351.0021(c)(2), which prohibits property tax lenders from charging any interest that is not expressly authorized under Texas Tax Code, §32.06. Additionally, the amendments are adopted under Texas Finance Code, §11.304, which authorizes the commission to adopt rules to enforce Title 4 of the Texas Finance Code. Enforcement authority under Title 4 includes the authority to enforce Texas Tax Code, §32.06, as provided by Texas Finance Code, §351.006(a).

The amendments are also adopted under Texas Tax Code, §32.06(a-4)(2), which authorizes the commission to adopt rules relating to the reasonableness of closing costs, fees, and other charges permitted under §32.06. By requiring discount points to be legitimate prepaid interest rather than disguised closing costs, the amendments help ensure that the charges imposed by the lender are reasonable.

The statutory provisions affected by the proposed amendments are contained in Texas Finance Code, Chapter 351, and Texas Tax Code, §32.06.

§89.207. Files and Records Required.

Each licensee must maintain records with respect to each property tax loan made under Texas Finance Code, Chapter 351 and Texas Tax Code, §32.06 and §32.065, and make those records available for examination under Texas Finance Code, §351.008. The records required by this section may be maintained by using either a paper or manual recordkeeping system, electronic recordkeeping system, optically imaged recordkeeping system, or a combination of the preceding types of systems, unless otherwise specified by statute or regulation. If federal law

requirements for record retention are different from the provisions contained in this section, the federal law requirements prevail only to the extent of the conflict with the provisions of this section.

(1) - (2) (No change.)

(3) Property tax loan transaction file. A licensee must maintain a paper or imaged copy of a property tax loan transaction file for each individual property tax loan or be able to produce the same information within a reasonable amount of time. The property tax loan transaction file must contain documents that show the licensee's compliance with applicable law, including Texas Finance Code, Chapter 351; Texas Tax Code, §32.06 and §32.065, and any applicable state and federal statutes and regulations. If a substantially equivalent electronic record for any of the following documents exists, a paper copy of the record does not have to be included in the property tax loan transaction file if the electronic record can be accessed upon request. The property tax loan transaction file must include copies of the following records or documents, unless otherwise specified:

(A) For all property tax loan transactions:

(i) - (ix) (No change.)

(x) written documentation of any legitimate discount points offered to the property owner, as described by §89.601(d) of this title, including the written proposal described by §89.601(d)(1)(C);

(B) - (M) (No change.)

(4) - (9) (No change.)

§89.601. Fees for Closing Costs.

(a) - (c) (No change.)

(d) Discount points. Legitimate discount points are prepaid interest and are not subject to the general maximum fee limit described by subsection (c) of this section.

(1) Discount points are legitimate if:

(A) the discount points truly correspond to a reduced interest rate;

(B) the discount points are not necessary to originate the loan; and

(C) before closing, the property tax lender provides the property owner with a written proposal describing the options offered to the property owner, including all of the following:

(i) an offer of a property tax loan that includes a contract rate without discount points and a corresponding annual percentage rate;

(ii) an offer of a property tax loan that includes a lower contract rate based on discount points and a corresponding annual percentage rate;

(iii) the difference between the contract rate without discount points and the lower contract rate, expressed as a percentage or as a number of points;

(iv) the cost of the discount points expressed as a dollar amount;

(v) the percentage amount equal to the cost of the discount points

divided by the principal balance of the loan; and

(vi) a statement that discount points are voluntary and not required to be paid in order to obtain the loan.

(2) If a property tax lender directly or indirectly charges, contracts for, or receives a discount point or other origination fee at closing that is not a legitimate discount point under paragraph (1) of this subsection, then the point or fee is subject to the maximum fee limit described by subsection (c) of this section. A property tax lender may not use the term "discount point" to describe a fee other than a legitimate discount point.

(3) To determine whether a property tax loan exceeds the 18% maximum effective rate of interest described in Texas Tax Code, §32.06(e), legitimate discount points must be included in the calculation of the effective rate. Upon prepayment in full, a property tax lender must spread legitimate discount points in accordance with Texas Finance Code, §302.101.

(4) All legitimate discount points must be paid by the property owner by cash, check, or electronic funds transfer before or at closing of a property tax loan. Discount points may not be included in the funds advanced described by Texas Tax Code, §32.06(e), or in the principal balance upon which interest is calculated.

(5) A property tax lender may not finance any discount points through a separate promissory note or contract, if the note or contract is payable to the property

tax lender or to an affiliated business of the property tax lender.

~~[(d) Discount points. A property tax lender may not charge any discount points in connection with a property tax loan. A property tax lender may not use the term "discount point" to describe any fee or charge in connection with a property tax loan. This prohibition applies to all property tax loans, notwithstanding subsection (a).]~~

§89.802. Payoff Statements.

(a) - (b) (No change.)

(c) Required elements. A payoff statement under this section must include:

(1) - (8) (No change.)

(9) an itemization of the total payoff amount, which must include:

(A) the unpaid principal balance on the property tax loan;

(B) the accrued interest as of the balance date; ~~and~~

(C) any refundable amount resulting from unearned legitimate discount points described by §89.601(d) of this title (relating to Fees for Closing Costs); and

(D) [€] any other fees that are part of the total amount due under the property tax loan, with a specific description for each fee;

(10) - (13) (No change.)

(d) - (l) (No change.)

Certification

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be within the agency's legal authority to adopt.

Issued in Austin, Texas on June 19, 2015.

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