

## **Recent Texas Supreme Court Decisions Affect Home-Equity Lending in Texas**

The [Texas Constitution](#) is strict about protecting the homestead. In fact, until 1997, the Texas Constitution did not permit home-equity loans to be secured by borrowers' homesteads. Even now, home-equity liens are allowed only under certain conditions, among which is the requirement that a home-equity loan be made on the condition that the lender or holder will forfeit principal and interest if the loan is constitutionally noncompliant and the lender fails to cure particular issues, using one of six listed corrective actions, within 60 days of receiving notice of the violation from the homeowner. On May 20, 2016, the Texas Supreme Court announced two decisions (*Garofolo* and *Wood*) that will significantly affect home-equity lending in Texas.

In *Garofolo*, the borrower alleged that she never received a release of lien in recordable form after she paid off her home-equity loan, even though it was required by the Texas Constitution and her loan agreement. Garofolo notified the servicer that she had not received the release and, when the servicer did not provide the release within 60 days, Garofolo sued for forfeiture of all principal and interest paid to the servicer.

The Texas Supreme Court considered: (1) whether there is a constitutional right to forfeiture of principal and interest when a lender is notified of a violation of Texas Constitution's requirement to provide a release of lien in recordable form after payoff of a home-equity loan, yet fails to provide the release within 60 days; and (2) whether there is a contractual right to forfeiture under the same circumstances. The Court answered "no" to both questions.

First, the Court held that **the Texas Constitution provides "freedom from forced sale to satisfy" home-equity debts that do not comply with that constitution.**

As the Court explained, the constitution operates by requiring certain provisions to be contained in the terms of the loan, and "compliance is measured by the loan as it exists at origination." It consequently may be "used as a shield from foreclosure," not as a sword to obtain forfeiture as "a constitutional remedy unto itself." Thus, Garofolo's constitutional claim for forfeiture of all paid principal and interest based on the servicer's alleged failure to comply with the Texas Constitution was dismissed.

Second, the Court held that, "[a]lthough the forfeiture remedy incorporated into Garofolo's loan might be applicable to a lender's failure to comply with some of her loan's terms, it does not apply to a failure to deliver a release of lien." This is

because the 2003 amendments to **the Texas Constitution, which added six corrective measures, limited the applicability of the forfeiture remedy to those failures to comply that can be “actually correct[ed]” by the enumerated measures.** If, as with the failure to deliver a copy of the release of lien in recordable form, “the lender cannot correct its failure to comply ‘by’ performing one of” the corrective measures, then “forfeiture is simply unavailable.” Accordingly, **to maintain a breach-of-contract action premised on the lender’s failure to deliver a release of lien or another purported violation of the terms required by the constitution that cannot actually be corrected, borrowers must allege and prove actual damages or an entitlement to some other contractual remedy.** Garofolo did not do so.

In *Wood*, the borrowers asserted, among other causes, claims for quiet title and declaratory judgment of forfeiture because the lender and servicer allegedly failed to cure purported defects in the Woods’ home equity loan, allegedly rendering it noncompliant with the constitution. The trial court granted defendants’ motion for summary judgment because the Woods filed their complaint after Texas’s four-year statute of limitations on quiet title actions had run. The court of appeals affirmed the dismissal—in accord with the Fifth Circuit and every other Texas appellate court to consider the question—but the Texas Supreme Court reversed.

The Supreme Court held that the Texas Constitution’s “clear, unequivocal, and binding” language that “[n]o . . . lien on six a homestead shall ever be valid unless it secures a debt described by this section” means that **“liens securing constitutionally noncompliant home-equity loans” are essentially void until cured.** As a result, the statute of limitations does not start running. Because the lien securing the Woods’ home-equity loan was allegedly void, their action to quiet title to their property could not be dismissed as time-barred.

The Woods’ constitutional declaratory judgment action for forfeiture, however, was barred by *Garofolo*. There is no constitutional right to forfeiture – **the Texas Constitution’s homestead provisions may be used only to shield homeowners from foreclosure,** and the defendants were not trying to foreclose on the property.

Together *Garofolo* and *Wood* provide insights about home-equity lending in Texas. In holding that the **Texas Constitutions’ homestead provisions are purely a defense to foreclosure and limiting the applicability of the forfeiture remedy,** *Garofolo* clarified that those provisions work through the terms of the home-equity loan agreement, rather than as a freestanding, affirmative constitutional cause of action. That holding cabins a potentially harsh constitutional forfeiture provision.

On the other hand, the holding in *Wood* that **the lien securing a non-compliant home-equity loan is void, rather than voidable, and that a borrower's claim to quiet title is not subject to the four-year statute of limitations**, could affect many outstanding home-equity loans.