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Principal balance paid off by home equity loan is not included in 80/20 calculation

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The Texas Constitution details the required terms and conditions of home equity loans and the rights and obligations of borrowers and lenders on such loans. Homeowners who have either entirely repaid their home loans or who have accumulated equity in their homestead may apply for a loan against that equity as long as the home equity loan:

> is of a principal balance that when added to the aggregate total of the outstanding balances of all other indebtedness secured by valid encumbrances of record against the homestead does not exceed 80 percent of the fair market value of the homestead on the date the extension of credit is made.
>
> Tex. Const. art. XVI, § 50(a)(6)(B).

In a recent case, *Bank of New York Mellon v. Daryapayama,* No. 05-14-00268-cv, 2015 WL 708620 (Tex. App.—Dallas February 19, 2015), the Dallas Court of Appeals clarified that the principal balance of loans being paid off by a new home equity loan are not included in the calculation determining whether the encumbrances of record against the homestead exceed 80% of the fair market value of the homestead on the date the home equity loan is made. In *Bank of New York Mellon*, the borrowers purchased a $1.5 million house and financed $735,000 of the purchase price with two loans secured by liens on the home. The borrowers later obtained a home equity loan for $937,500 for the purpose of paying off the original mortgages totaling $735,000. A few years later, the borrowers defaulted on the home equity loan and Bank of New York Mellon, the assignee of the loan, foreclosed on the borrowers' property. When Bank of New York Mellon filed a forcible detainer to remove the borrowers from the property, the borrowers filed a counterclaim contending that because the $937,000 home equity loan combined with their outstanding $735,000 mortgages exceeded 80% of the home's value, the foreclosure was unenforceable, the lien violated the Texas Constitution and the debt should be discharged. The trial court agreed with the borrowers' contentions and granted summary judgment in their favor.

The Dallas Court of Appeals reversed the trial court, holding that because the loan documents reflected that the $937,000 home equity loan was made, in large part, to pay off the existing mortgages, the trial court erred by including the balance of those loans in its calculation of the total amount of indebtedness. In particular, the Court of Appeals noted that the evidence clearly showed that the home equity loan was for "Payoff of Mortgage" and the Texas Home Equity Security Instrument (First Lien) detailed how the home equity loan proceeds would be disbursed to payoff the mortgage. The key take away is that the documentation underlying a home equity loan should clearly reflect the use of the proceeds and evidence that the home equity loan will not result in encumbrances against the homestead exceeding 80% of the fair market value of the homestead after the home equity loan is closed.

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