

In Texas, the term “cash out” is commonly used to describe a home equity loan originated under Section 50(a)(6), Article XVI of the Texas Constitution. However, the term “cash out” is also used to define a refinance transaction under the Fannie Mae Selling Guide, and in this context often carries a different—and sometimes contradictory—meaning. Therefore, it is important for lenders to understand the distinctions between Fannie Mae’s refinance definitions and those under Texas law, and lenders should not rely on Fannie Mae’s categorization of refinance loans for purposes of determining compliance with the provisions of Texas Constitution.

TEXAS REFINANCE CLASSIFICATIONS ON HOMESTEAD PROPERTY¹

Under Texas law, a home equity loan is a loan secured by the borrower’s homestead in which the borrower either receives cash back directly or uses loan proceeds to pay off a debt that is not secured by a valid lien against the homestead. The loan is originated under the authority of and must be in compliance with Section 50(a)(6), Article XVI of the Texas Constitution, and is often referred to as a “home equity loan” or a “TX 50(a)(6) loan”.

Texas law permits a refinance conversion of a TX 50(a)(6) loan into a non-equity loan under Article XVI, Section 50(f)(2) of the Texas Constitution, also known as a “conversion refinance” or “TX 50(f)(2) loan”. If the new refinance loan is paying off an existing TX 50(a)(6) and the borrower is not receiving cash back or using loan proceeds to pay off a debt that is not secured by a valid lien against the homestead, the new loan may convert to a non-equity loan under TX 50(f)(2).

A “rate and term” refinance under Texas law is a new lien upon the homestead which refinances an existing valid lien upon the homestead (other than a home equity loan), and the borrower does not receive any cash at closing.

FANNIE MAE REFINANCE CLASSIFICATIONS

Fannie Mae classifies a refinance loan as either a “limited cash-out refinance” or “cash-out refinance”. In a limited cash-out refinance, the new loan is used to pay off an existing first mortgage and may include the payoff of a subordinate purchase-money lien. The transaction is ineligible as a limited cash-out refinance if there is no outstanding first lien on the property, or if loan proceeds are used to pay off a non-purchase money second lien (*Fannie Mae Selling Guide*, B2-1.3-02, Limited Cash-Out Refinance Transactions (06/03/2020)). In a Fannie Mae cash-out refinance, the new loan must be used to pay off existing mortgages or be a new mortgage on a property that does not have a lien against it (*Fannie Mae Selling Guide*, B2-1.3-03, Cash-Out Refinance Transactions (10/07/2020)).

To help illustrate the different ways refinance transactions may be treated under the Fannie Mae Selling Guide and closed under Texas law, we have prepared the attached matrix.

¹ If the subject property is not the borrower’s homestead, then these classifications, including the home equity provisions, do not apply.

REFINANCE TRANSACTIONS – FANNIE MAE v. TEXAS LAW

Common Loan Scenarios^{2,3,4}	Cash Back?	Fannie Mae Selling Guide	Texas Law⁵
Paying off an existing first mortgage [non-TX 50(a)(6)]	No	Limited Cash-Out	Rate and Term
	Yes	<ul style="list-style-type: none"> ➤ Limited Cash-Out, if cash back is not more than the lesser of 2% of the new loan amount or \$2,000 ➤ Cash-Out, if more 	TX 50(a)(6)
Paying off an existing first TX 50(a)(6)	No	Limited Cash-Out	TX 50(a)(6) or TX 50(f)(2)
	Yes	<ul style="list-style-type: none"> ➤ Limited Cash-Out, if cash back is not more than the lesser of 2% of the new loan amount or \$2,000 ➤ Cash-Out, if more 	TX 50(a)(6)
Paying off an existing first mortgage [non-TX 50(a)(6)] and purchase-money second	No	Limited Cash-Out	Rate and Term
	Yes	<ul style="list-style-type: none"> ➤ Limited Cash-Out, if cash back is not more than the lesser of 2% of the new loan amount or \$2,000 ➤ Cash-Out, if more 	TX 50(a)(6)
Paying off an existing first mortgage [non-TX 50(a)(6)] and non-purchase-money second [non-TX 50(a)(6)]	No	Cash-Out	Rate and Term
	Yes	Cash-Out	TX 50(a)(6)

² Assumes that the subject property is the borrower’s homestead.

³ An existing Texas home equity lien [“TX 50(a)(6)”] includes a closed-end home equity loan or a home equity line of credit.

⁴ Existing liens are assumed to be valid liens against the homestead under Texas law.

⁵ Texas law permits a refinance conversion of a Texas home equity loan into a non-equity loan under Article XVI, Section 50(f)(2) of the Texas Constitution [“TX 50(f)(2)”]. If the new loan is paying off an existing TX 50(a)(6) and the borrower is not receiving cash back, the new loan may remain an equity loan under TX 50(a)(6) or convert to a non-equity loan under TX 50(f)(2).

Paying off an existing first mortgage and TX 50(a)(6) second	No	Cash-Out	TX 50(a)(6) or TX 50(f)(2)
	Yes	Cash-Out	TX 50(a)(6)
Paying off an existing first TX 50(a)(6) and purchase-money second	No	Limited Cash-Out	TX 50(a)(6) or TX 50(f)(2)
	Yes	<ul style="list-style-type: none"> ➤ Limited Cash-Out, if cash back is not more than the lesser of 2% of the new loan amount or \$2,000 ➤ Cash-Out, if more 	TX 50(a)(6)
Paying off an existing first TX 50(a)(6) and non-purchase-money second	No	Cash-Out	TX 50(a)(6) or TX 50(f)(2)
	Yes	Cash-Out	TX 50(a)(6)
New mortgage on a property that does not have a mortgage lien against it	Yes	Cash-Out	TX 50(a)(6)
Paying off an existing first purchase-money mortgage and home improvement second (ex: pool)	No	Cash-Out	Rate and Term
Single-close construction-to-permanent loan to finance construction costs to build the home (may include the payoff of an existing lot lien)	No	Limited Cash-Out	Rate and Term
Paying off an existing first mortgage [non-TX 50(a)(6)] and buying out a co-owner's interest [existing owelty lien]	No	Limited Cash-Out	Rate and Term
Paying off an existing first mortgage [non-TX 50(a)(6)] and buying out a co-owner's interest [no existing owelty lien]	No	Limited Cash-Out	TX 50(a)(6)

New mortgage to buy out a co-owner's interest [owelty lien is the only existing lien against property]	No	Cash-Out	Rate and Term
New mortgage to buy out a co-owner's interest [no owelty lien and no existing mortgage lien]	No	Cash-Out	TX 50(a)(6)
Paying off an existing first mortgage [non-TX 50(a)(6)] and property tax liens	No	Cash-Out	Rate and Term
Paying off an existing first reverse mortgage	No	Limited Cash-Out	Rate and Term